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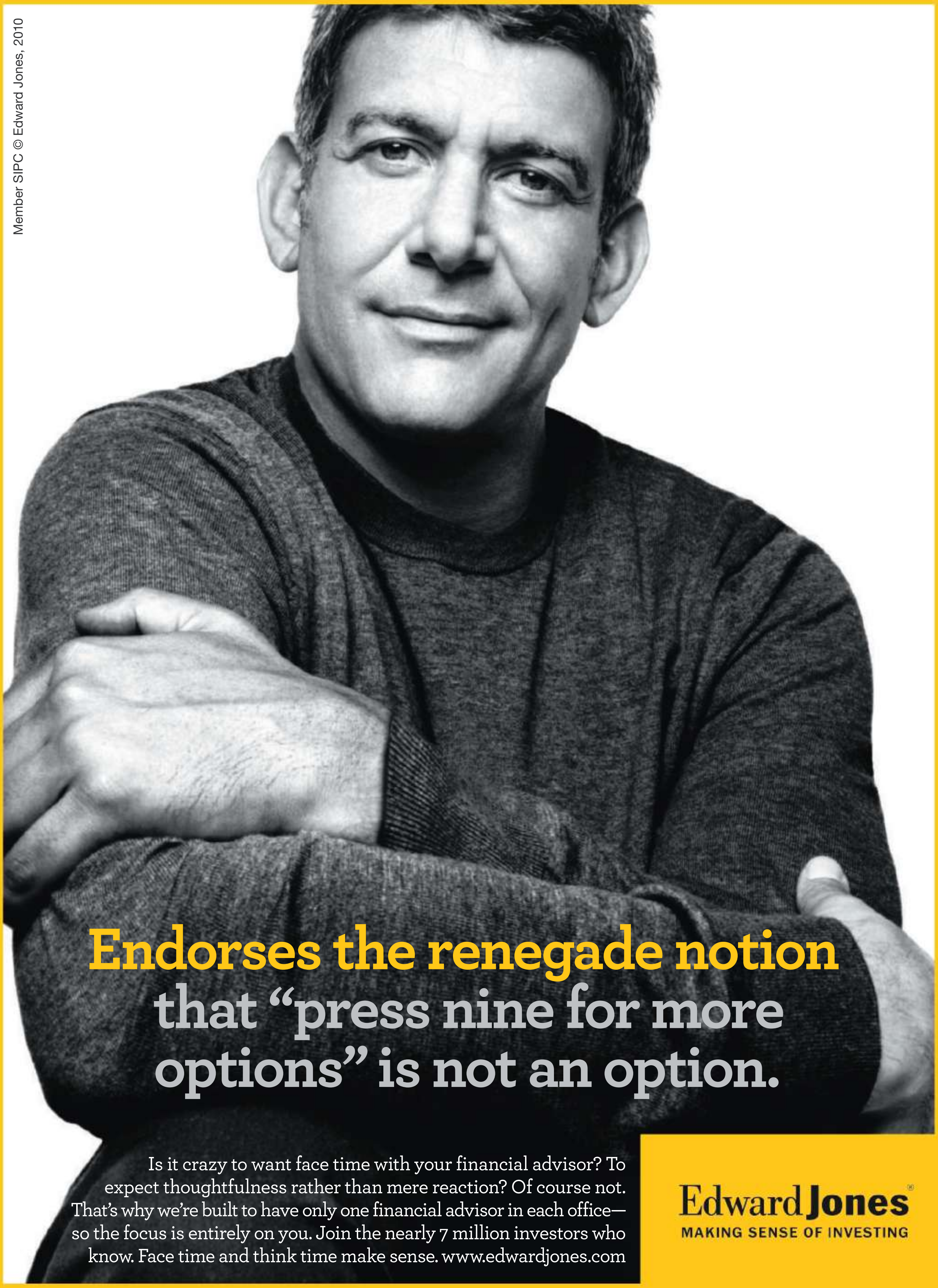
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Shred the Debt



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Ireland is struggling to cover the debts of its reckless banks. American homeowners are wheezing, too. Time for debt writedowns. By Peter Coy

There is no end in sight to Ireland's debt crisis, but here's one thing we know: The Irish will not get kicked out of their own country. No matter how many multiples of the nation's gross domestic product are owed to German and U.K. banks, sovereign foreclosure is not an option.

In most other respects, though, the state of Ireland is similar to the predicament that 1 in 5 American homeowners with mortgages find themselves in—owing more than their property is worth, so burdened with debt that the economy is stalled by their inability to borrow and spend as they used to. With homeowners, at least, there's foreclosure, which is devastating but creates hope that debtors might regain something close to a normal life, albeit as renters. Those determined to stay in their own homes need something lenders have thus far been reluctant to offer: a reduction in principal, a lessening of the debt. Another word for it is a haircut. The entire taxpaying public of Ireland, it turns out, needs the same thing done to the debts it acquired in saving the nation's reckless banks. A growing chorus of economists, including Carmen Reinhart of the University of Maryland, is making this argument. But policymakers have shown few signs of even considering it. Why?

The situation in Ireland certainly calls for dramatic action. In Dublin, a protester driving a cement truck emblazoned with the words "TOXIC BANK" rammed the ornate iron gate of the Irish Parliament early on Sept. 29. Later that day, inside the purple-carpeted chamber of the lower house, representatives from opposition parties grilled Prime Minister Brian Cowen over the enormous cost of bailing out Anglo Irish Bank, the shaky real estate lender Ireland was forced to nationalize in January 2009 after Irish land prices fell as much as 70 percent from their peak. "What you have done with this government has crushed the spirit of the people," said Enda Kenny, leader of the opposition Fine Gael party.

Ireland illustrates why governments need to make private creditors share the pain. The bursting of its real estate bubble left the country overwhelmed with bad debts and forced the government

Opening Remarks

Before private debt becomes public, it's important that it do so at a very realistic price. ... And that means big haircuts
Carmen Reinhart, University of Maryland

to impose painful budget cuts. Embracing austerity has won Ireland the praise of the European Union—and little else. The Irish economy shrank at an annual rate of 5 percent in the second quarter because the sharp reduction in government spending hasn't been offset by a jump in private spending. And its borrowing costs have surged. Investors now have to pay 4.7 percent of the face value of Irish government bonds annually to protect against the risk of default for five years, 12 times the cost for insurance on German bonds.

What's forcing up borrowing costs is the Irish government's fateful September 2008 decision to throw a blanket taxpayer guarantee over all the liabilities of Ireland's six big banks. Three have since been nationalized. Standard & Poor's projects that the bailout of Anglo Irish alone might ultimately cost €35 billion or more. Measured against the size of the economy, that's comparable to a $3 trillion bailout for a single U.S. bank. On Sept. 30, after this magazine's deadline, the Irish government was set to present its plan for winding down Anglo Irish. Advance word was that the government still aimed to repay the bank's senior bondholders in full. "Burning" bondholders "would be an absolute, utter disaster," Dick Roche, a junior minister, told Dublin-based broadcaster RTE on Sept. 26.

Like Ireland, the U.S. has been slow to impose big losses on creditors. That pattern goes back to 2008, when the government took over American International Group, then the world's biggest insurer, and fully insulated AIG's bondholders from losses. Today, protected creditors include banks that made unwise loans, bondholders and other lenders to those banks, and holders of securities backed by mortgages, auto loans, credit-card receivables, and other debts. Mike Larson, a real estate analyst for Weiss Research in Jupiter, Fla., says that by modifying loans without reducing what people owe, "You're not fixing the problem. You've got to start thinking about principal reductions."

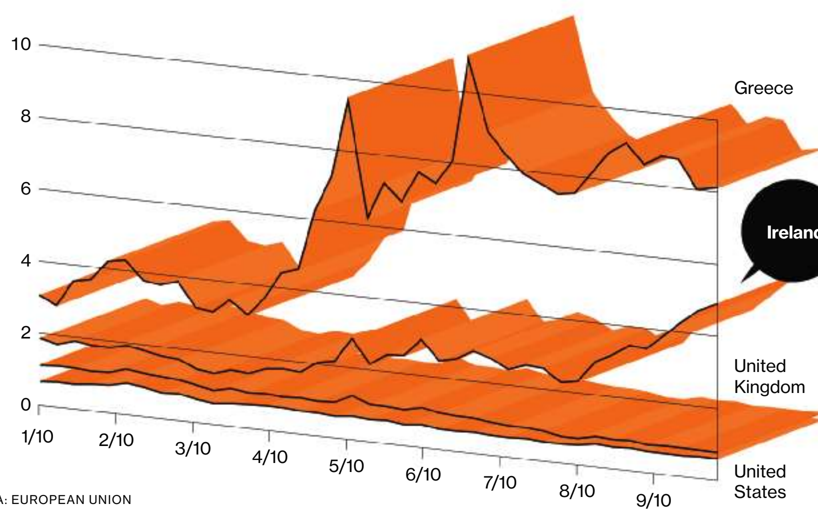
The foot-dragging on writedowns is most obvious in the failure of mortgage-modification efforts by both George W. Bush and Barack Obama. To save mortgage lenders from having to post big losses, the efforts steered away from principal writedowns, focusing instead on reducing interest rates or stretching out loan terms to lower payments. According to the State Foreclosure Prevention Working Group, an organization of state attorneys general, "the vast majority" of mortgage modifications raised rather than reduced the amount of money homeowners owed.

Creditors object that debt forgiveness will encourage bad behavior. People, they say, will borrow recklessly knowing that if things go bad they won't be required to pay it all back. This argument has merit. However, it's equally misguided for the government to guarantee penny-for-penny repayment of private debts. That encourages even more foolish lending because creditors know they'll be fully protected from the consequences of their dumb lending decisions. Says Reinhart: "Before private debt becomes public, it's important that it do so at a very realistic price so it doesn't inflate the government balance sheet unnecessarily. And that means big haircuts."

One way or another, the world's savers and investors are going to have to pay the bill for unrecoverable debts. The question is whether that happens in a rip-the-Band-Aid-off round of debt reduction or is dribbled out over years in the form of government-induced inflation (which will ease the burden of debt while eating away at the value of savings). Policymakers are clearly concerned about the potential consequences of principal reduction. If my neighbor gets his mortgage reduced, why not mine? The stigma will be gone, and then who knows what happens? It's scary, all right. Yet the situation in Ireland shows there may be no alternative. Ⓑ

—With Dara Doyle and Joe Brennan

Ireland Is Catching Up with Greece
Annual cost of insuring national debt against default for five years, as a percentage of the face value of the debt.



DATA: EUROPEAN UNION

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Global Economics



The Untold Wealth of Unknown Cities

▶ **Suddenly affluent towns in India, China, and Brazil are luring marketers**

▶ **"This is a place of potential buyers—people should take notice"**

Ever heard of Aurangabad, a dusty trading town in the heart of India? Neither, it seems, had **Daimler**, the No. 2 maker of luxury cars. So when a Mercedes-Benz dealership in Pune, a six-hour drive away, got a call from Aurangabad's chamber of commerce to place an order for 115 sedans, the sales clerk thought it was a joke.

It wasn't. In the last 10 years, Aurangabad has doubled in population to nearly 2 million, as Western companies such as engineering giant **Siemens** and brewer **SABMiller** built plants there and as Mumbai manufacturers found affordable sites for new factories. "Aurangabad has grown like anything, and people still thought of Aurangabad as this nothing town," says Sacheen Mulay, president of the local chamber of commerce and industry and a multimillionaire from his real estate projects. The idea for ordering en masse was cooked up by members of the chamber of commerce to get some attention for the new Aurangabad. "This is a place of potential buyers, new-generation entrepreneurs. People should take notice of that," says Mulay.

Daimler took note after Mulay and his colleagues went down to Pune with a PowerPoint presentation. The carmaker ultimately sold 148 autos to Aurangabad customers, the largest order in Asia, the company estimates. "We're clearly focused on these tier-two cities," says Wilfried Aulbur, chief executive officer of Daimler's India unit, who got involved personally in completing the order.

Some 460 million people, earning $5,000 to $10,000 a year, will join the middle class in the next five years

Most multinationals build a large presence in the top 10 cities of emerging-market countries such as Brazil, China, India, and Indonesia, so Rio, Shanghai, Delhi, and Jakarta get their state-of-the-art autos, cell phones, and retailers. Yet this focus comes at a cost. In a survey of multinationals, Boston Consulting Group found that most of the companies ignored cities with smaller populations and less apparent potential. Cities such as Aurangabad, Curitiba in Brazil, Xiaochang in China, and Yekaterinburg in Russia get lumped together, BCG found, with the mostly poor, rural populations that few companies, with notable exceptions

APOORVA SALKADE/OUTLOOK INDIA

Global Economics

India's Little-Known Big Cities

Untapped markets with increasingly affluent consumers



❶ Jaipur
Population
3.2 million

A big maker of industrial parts and processed food. Also an emerging power in outsourcing.



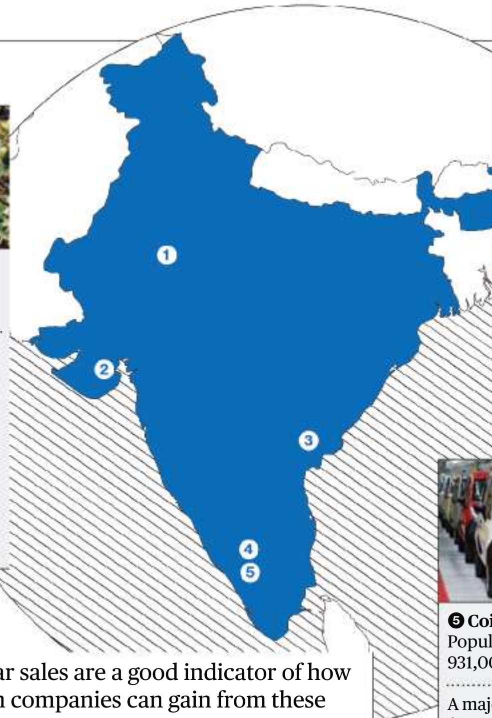
❷ Bhavnagar
Population
750,000

Known for diamond polishing, ship salvaging, plastics.



❸ Vijayawada
Population
2.3 million

A vital railroad junction on the East Coast and a big center for food processing, cotton, and auto bodies.





❹ Mysore
Population
799,000

Has imitated its neighboring city Bangalore and developed a thriving information technology industry.



❺ Coimbatore
Population
931,000

A major center for textiles, it now has a big share of the auto parts business for Maruti and Tata.

MAP FROM LEFT: HUGH SITTON/CORBIS; SHAILESH RAVEL/INDIA TODAY IMAGES; A PRABHAKAR RAO/THE INDIA TODAY GROUP/ GETTY IMAGES; ADEEL HALIM/BLOOMBERG; NAMAS BHOJANI/BLOOMBERG

such as **Unilever**, are eager to pursue. "The next billion consumers, who are far above the poverty line, have high consuming power, and they are just not coming onto people's radars," says Sharad Verma, a partner at BCG.

Cities with fewer than 5 million residents make up 83 percent of emerging markets' urban consumers, BCG estimates. By 2030, 1.3 billion more people will live in emerging-market cities, driving 67 percent of global gross domestic product growth. Fewer than a fifth of these consumers will live in megacities such as Mexico City. The rest, who will be able to afford new cars, iPhones, and flat-screen TVs, will be spread out among 1,100 cities with populations over 500,000, up from 717 such cities today. Some 460 million people, earning $5,000 to $10,000 a year, will join the middle class in the next five years.

In the few smaller towns where the world's top marketers do show up, the impact is immediate. Amritsar, a town in Punjab best known for the Sikh Golden Temple, is now a thriving trading center for rice and wheat. The Indian conglomerate **Bharti** teamed up with **Wal-Mart** to build the Arkansas retailer's first Indian store in Amritsar. Last summer, when reporters were given a tour, a traffic jam stretched a kilometer and a half down the road as farmers in tractors and Amritsaris in BMWs thronged the entrance.

Car sales are a good indicator of how much companies can gain from these towns, says Deepesh Rathore, managing director of IHS Global Insight India. Indians love cars, a visible marker of prosperity and a necessary purchase in places with little or no public transport. Yet **General Motors**' Chevrolet brand has less than 5 percent of the Indian market, even with eight models ranging from cheap to very expensive. "The most successful car for GM sells 4,000 units a year, which compares to a moderately selling car for **Maruti Suzuki**, the market leader," says Rathore. "GM has such a limited sales and service network that there's a big chunk of the population they just can't tap." Maruti has 802 sales centers in 555 cities; GM has about 200, mostly in the bigger cities.

Some Indian companies are quickly moving into smaller towns. **PVR Cinemas**, a Gurgaon-based chain whose shares have risen 75 percent since 2009, is betting its future on places most people can't find on the map—towns such as Nanded, Ujjain, and Vijayawada, says CEO Pramod Arora. "Smaller towns and cities offer immense opportunities, where the consumer base will grow at a phenomenal rate, while the bigger cities will taper off," he says.

Today, PVR has 70 percent of its multiplexes in cities such as Delhi and Mumbai. In those markets most customers pay $6 to $10 to be ushered into slick lobbies, where ads on LCD TVs hawk popcorn and sandwiches. Some even pay $22 for a reclining leather seat and waiter service. In the next two years only half of PVR's screens will be in the big cities, says Arora. Smaller theaters with fewer frills, charging $2 to $4 in cities such as Latur, will soon make up most of PVR's sales. Margins are expected to go up as PVR adds Mumbai-like amenities and customers make enough money to afford higher prices.

Back in Aurangabad, the 148 Benzes are expected to arrive in October. The owners can then drive to the new $66 million mall, one of Asia's largest, which opens in a month under the management of India's **Provogue**, a men's apparel maker, and London-based **Capital Shopping Centres Group**, which owns nine of Britain's

Quoted

"Paul Volcker reestablished Fed independence. I regret to say that Ben Bernanke has thrown away most of that independence by financing the deficit, by negotiating purchases of housing, by doing all sorts of fiscal policy the Fed should not be doing."

—Allan Meltzer, professor at Carnegie Mellon and author of *A History of the Federal Reserve*



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Harley wants women at the handlebars page 25 ▶

largest malls. Coimbatore, Indore, and Nagpur will get malls next, says Capital Shopping CEO David Fischel. On **YouTube**, meanwhile, a 3D walkthrough of the Aurangabad mall triggers such comments as "It's really heaven come to our city" and "Bravo, we are waiting for it." Sounds like a sales opportunity. —*Mehul Srivastava*

The bottom line *Smaller cities in Indian and other emerging markets offer the next big growth opportunity for multinationals.*

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▶ **Rosatom's Reach**

Reactors under construction worldwide, listed by supplier (includes exporters only)

Rosatom (Russia)	**15**
Korea Electric Power (S. Korea)	6
Westinghouse (U.S.)	5
Areva (France)	4
General Electric-Hitachi	4

DATA: WORLD NUCLEAR ASSN., COMPANY REPORTS

Russia, one of the world's biggest oil and gas exporters, aims to become a global leader in nuclear power, too. State-owned nuclear group Rosatom now has 15 reactors under construction worldwide, more than any other international supplier (table). Five of the 15 are outside Russia, and more are coming soon.

On Sept. 26, Rosatom announced a deal to supply two reactors to China, in addition to two it has already built. "China's not even the No. 1 priority now, as we have larger-scale partnerships in India, Turkey, and in the future, Vietnam," Rosatom Chief Executive Officer Sergei Kiriyenko said.

Emerging-market countries are ordering most of the new reactors nowadays, as projects in developed countries are slowed by political opposition. Rosatom is ready to compete on price: According to the Organization for Economic Cooperation and Development, construction of a 1,000-zmegawatt plant in Russia costs an average $2.9 billion, exclusive of financing. That's 20 percent to 50 percent less than plants built by Western rivals.

The Russians have overhauled their nuclear technology since the Chernobyl fiasco. "The power reactors they are offering the world are the same basic design everyone else is offering," says Mark Hibbs, a Berlin-based senior associate in the nuclear policy program at the Carnegie Endowment for International Peace. "Outside experts judge it to be safe." Nonetheless, he adds, "In some nuclear markets, decision makers both commercially and politically still are a little nervous about this."

Kiriyenko has been pushing to expand global sales since 2005 when he took the helm of Russia's atomic-energy ministry, which became a state-owned company in 2008. The 48-year-old CEO, who served briefly as Prime Minister under Boris Yeltsin, says he wants to boost Rosatom's annual sales from $17 billion now to more than $50 billion over the next 20 years.

As a state-owned company, Rosatom benefits from the Kremlin's help in clinching deals at high levels. Its sale of two reactors to India last March was sealed during a trip to New Delhi by Prime Minister Vladimir Putin, who also agreed to sell the Indians 29 MiG fighters and other arms. The September sale to the Chinese was signed in Beijing the same day as a Russian agreement to supply natural gas to China. Rosatom is also the only nuclear vendor willing to take back spent fuel from its customers, according to the World Nuclear Assn. Most countries, including the U.S. and France, prohibit the long-term storage and disposal of wastes from commercial reactors outside their borders.

Rosatom's toughest rival may prove to be **Korea Electric Power.** The reactors Kepco builds in Korea cost about one-third less than Rosatom's, according to the OECD. And this year, Kepco inked its first export deal, to supply four reactors to Abu Dhabi for $20 billion. "The benchmark to beat now is the Korean price," says Chris Gadomski, a nuclear specialist at analysis group Bloomberg New Energy Research.

Kiriyenko is still preparing for a boom in sales. To ensure steady fuel supplies to customers, Rosatom spent $610 million in June for a controlling stake in Canada's **Uranium One.** In an upcoming joint venture with **Siemens,** the German company will provide turbines for Rosatom plants. New products are coming, too, including next-generation fast reactors and floating reactors that can be hauled by ship to remote locations. —*Carol Matlack and Yuriy Humber with Lyubov Pronina*

The bottom line *Russia has revived its reactor exports by targeting emerging markets. Rosatom is an industry leader in reactor sales abroad.*

38,820

POINTS

Dow Jones industrial average in 2025, as predicted by Jeffrey A. Hirsch, editor-in-chief of the *Stock Trader's Almanac*

GDP

Why One Economist Predicts Slow Growth

▶ **Northwestern's Gordon sees a drag from boomer retirements**

▶ **No revolution in technology to lift the GDP numbers**

Robert J. Gordon of Northwestern University belongs to the committee of distinguished economists who officially declared on Sept. 20 that the U.S. recession ended way back in June 2009. Don't mistake that pronouncement for optimism. According to Gordon's research into the long-term determinants of growth, America's next two decades are going to be disappointing. He predicts that between 2007 and 2027, gross domestic product per capita will grow at the slowest pace of any 20-year period in

Global Economics

U.S. history going back to George Washington's Presidency. Although the data he examined closely go back only to 1891, he says that based on his knowledge of early American economic history, he thinks it is fairly safe to predict that the period will witness the slowest growth ever in GDP per capita and, therefore, American living standards.

Gordon isn't out on a limb. His prediction is based on several strands of existing research on workforce demographics, educational attainment, and technological change. His contribution has been to pull the strands together and draw the logical conclusion. According to data Gordon prepared for *Bloomberg Businessweek*, based on research he published earlier this year, GDP per capita in the U.S. grew at a robust 2.44 percent annual rate from 1928 to 1972. That slowed to 1.93 percent from 1972 to 2007 and is likely to slow further, to 1.5 percent from 2007 to 2027. At that rate, GDP per capita would increase by a total of 35 percent by 2027. That's far short of the 62 percent that it would grow if the 1928-1972 pace of growth had continued, or the 47 percent increase if the 1972-2007 pace had continued.

What's behind this forecasted stretch of slow growth? One major reason, Gordon says, is the coming retirement of the baby boomers, which will decrease productive wage-earners as a share of the population. That demographic negative would be tolerable if the workers who remain on the job rapidly increased their productivity, or output per hour. Gordon doesn't see that happening. For one thing, he says, education levels in the U.S. have stopped increasing: It's usually hard to raise productivity in the long run without better-educated workers.

For another, there's no reason to predict another technological revolution like the Internet boom, which briefly boosted productivity in the early 2000s. Gordon says the past decade has disproved economists who believe that the Net had a "magic quality" that would speed up productivity growth for an extended period. That was a common theme for investors at the time of the tech boom of the late 1990s, when some "New Economy" believers insisted that productivity growth had reached a new, higher plateau. Not so, says Gordon: "What we're going through now is a transformation to smaller devices without a change in the basic idea of computers communicating with each other," he says.

Labor productivity grew a strong 3.5 percent in 2009 and continued at a 3.9 percent annual rate in the first quarter of 2010. Those big gains in output per hour seemed to presage healthy gains in standards of living over time. But Gordon considers the big productivity jump a fluke, noting that employers cut jobs more drastically than in previous cycles. "It was a general panic to cut costs" that wasn't sustainable, he says. One sign that employers cut too much is that they've had to backtrack: Productivity declined at a 1.8 percent annual rate in the second quarter, although that decline isn't expected to continue for the whole year.

If living standards do rise more slowly over the next couple of decades, it will become even harder for the U.S. to fix costly problems, from carbon emissions to poverty. It's always easier to share a pie that's growing. More education and innovation would help. For Gordon, that's for someone else to worry about. His job is to run the numbers.
—*Peter Coy*



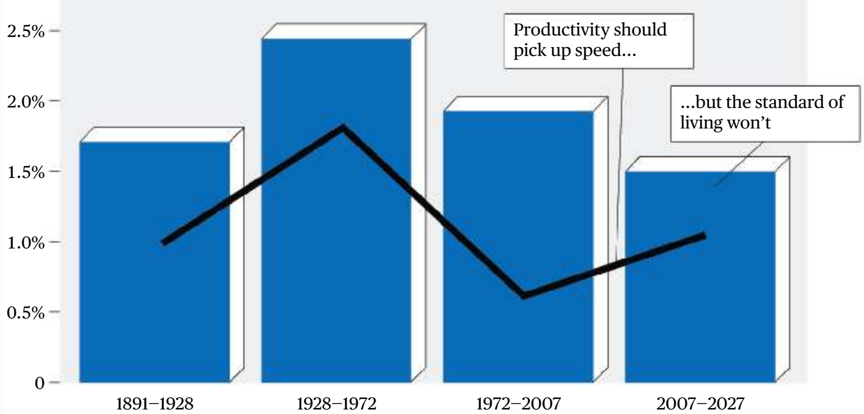
Cigarette sales will give the economy more of a lift than the stimulus

Credit Markets

A Gloomy 20-Year Outlook for America

Northwestern University economist Robert J. Gordon projects that gross domestic product per capita will grow from 2007 to 2027 at the slowest pace since the nation's founding. —*Peter Coy*

■ Annual growth rate of multifactor productivity*
■ Annual growth rate of gross domestic product per capita



* Output gains that are achieved through improvements in efficiency rather than through increased use of labor or capital

DATA: ROBERT J. GORDON

The bottom line *Economist Robert Gordon predicts the U.S. will soon be generating the slowest GDP growth per capita in its history.*

FROM TOP: TOMOHIRO OHSUMI/BLOOMBERG; ANDREW HARRER/BLOOMBERG

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Taxes

Japan Enjoys a Nice, If Fleeting, Nicotine Buzz

▶ The Japanese hoard cigarettes ahead of a big tobacco tax hike

▶ "Thirty cartons has been the norm," says one tobacco retailer

A man walked into Yusuke Sato's tobacco store in Atsugi, southwest of Tokyo, last month and bought 100 cartons of Mild Seven cigarettes. While that may not be good for his health, it did save him almost $1,300 in potential cigarette taxes. Hoarding by Japanese smokers, who stocked up ahead of a big tax increase on cigarette manufacturers that took effect on Oct. 1, may have also given Japan the economic equivalent of a nicotine rush.

A big spike in cigarette sales may add as much as 1.4 percentage points to the projected annualized economic growth rate for the July-to-September quarter, according to estimates from the Japan Research Institute. That's more than four times the expected economic oomph of Prime Minister Naoto Kan's 915 billion yen ($10.9 billion) proposed stimulus package. "We were afraid we would run out of stock," says Sato, who started taking reservations for cartons in August. "Thirty cartons has been the norm." The cigarette tax hike this month, Japan's biggest ever, effectively increased the price of a pack by a third.

Former Prime Minister Yukio Hatoyama, who stepped down in June, proposed the tax increase last year to discourage tobacco use in a country where 2008 Labor Ministry data showed 36.8 percent of men and 9.1 percent of women regularly smoked. The average Japanese smoked 2,028 cigarettes in 2007, according to U.K.-based market researcher ERC Group. That's about twice as much as Americans and Germans and almost three times as much as Swedes. (In volume terms, Japan is the fourth-largest market for the world's tobacco makers, after China, the U.S., and Russia.)

Japan Tobacco, the world's third-largest publicly traded cigarette maker, which controls 65 percent of its home market, is raising prices on 103 of its 105 brands in October. A pack of its flagship Mild Seven brand will cost 410 yen, up 110 yen. In dollar terms, that's still far cheaper than the $10.80 average price for a pack in the U.S.

Japanese smokers don't face the same social stigma as ➜ 16

Tom Keene's EconoChat

Tom talks with **New Jersey Governor Chris Christie** about state pensions

Governor, what is your biggest headache these days?
Our pension system [for state and local workers] in New Jersey is $46 billion underfunded. Even if the state made every dime of its contribution for the next 15 years, at the end we'd be $85 billion underfunded. Our health benefit plan is $67 billion underfunded.

What's the most important pension reform you'd like to make?
Raising the state worker retirement age to 65 from 62 is very important. I think also eliminating cost-of-living adjustments. The COLAs are an extraordinary cost driver in our pension costs. We also need to increase the pension contribution that public-sector employees are making to a uniform 8.5 percent [of salary]. Right now, a state employee pays anywhere from 3 percent to a high of 8.5 percent.

The unions aren't just going to lie down and take this.
They're already fighting. But I went before the firefighters' convention and I said, you know, I understand why you're angry. For 20 years governors have been lying to you about the kind of benefits they can provide you. I'm the first guy who's telling the truth, which is if we don't do these reforms, we are going to wind up with you not having a pension in 10 or 15 years.

How did that go over?
Better than you thought it would. In the beginning, probably a third of the folks there were booing. When we got done, it was much less than that. Ⓑ



Keene hosts Bloomberg Surveillance *7-10 a.m., 1130AM in New York, XM 129, Sirius 130.*

Charlie Rose talks to

Mongolia's Prime Minister



Sukhbaatar Batbold heads one of the last places on earth with huge, untapped metal ore reserves. The IMF says Mongolia will be one of the fastest-growing economies over the next decade

What do you expect Mongolia's growth rate to be over the next five years?
Despite losses in agriculture—we had a very hard winter and lost almost one-fifth of our [livestock]—we're still anticipating almost 8 percent GDP growth this year. And according to World Bank and IMF estimates, for the next five years we are expected to have growth above 10 percent per annum.

I just interviewed the President of Chile. Its largest market is China—especially for copper. Give us a sense of what the market is for minerals in Mongolia.
We are already the No. 4 exporter of coal to China. We are a quite serious exporter of copper to China, and with our copper and gold project with Rio Tinto, we would easily double and triple [copper] exports to China. There is huge potential. On top of that, we have new commodities to export to China—iron ore, zinc—and we do have some prospects for oil and gas and important reserves of uranium. But we are a landlocked country ... and transit costs equal almost 10 percent of GDP. So with encouragement from my government, we are [looking beyond the export of raw materials] to adding value in processing and putting more priority on industrialization, which will create jobs.

Are you entertaining the idea of nuclear power?
Not at this moment, but we are working closely with France, the U.S., Japan, Russia, and China, because we have so many reserves of uranium. We have lots of other sources of energy. Mongolia is, interestingly enough, the world's richest wind tunnel.

So wind power could be a huge?
Wind power could be a major opportunity for Mongolia and for export to China.

You're opening a national bourse that I think will be managed by the London Stock Exchange.
It's not decided yet ... but the London Exchange is one of the strong candidates because it is a mining-specialized exchange. That decision will be made by an independent board.

Here's what I hear you saying. You have a country the size of Western Europe, a small population, lots of mineral resources, a developing market system, and predicted double-digit growth in GDP. What's the problem?
The big problem is: How do we manage this wealth? We have about 4 or 5 percent unemployment. That is the official number, but a substantial segment of the population is not registered yet. And the poverty level is above 35 percent. So we need to channel this wealth to combat poverty.

And eliminate the possibility of social tension?
Absolutely.

What's the economic model? Is it more like the U.S. or China? Or is it some hybrid?
After 20 years of transition, we're trying to define which would be the best model for us. And we have seen the Chilean model, because Chile is a mining country. We are looking now at Canada and what it has achieved because although there are big differences in development and other things, there are a lot of natural similarities between Mongolia and Canada. We're cold countries with vast territories, smaller populations relatively, and mining and agriculture are key. And we're next door to major neighbors like the U.S., China, and Russia.

Do you have influence with North Korea?
To say influence is a little difficult. What we have are very good relations. We have an embassy in Pyongyang; they have one in Ulan Bator. We have cultural-exchange events on a continuing basis. And we even have economic and trade commissions that work together. We try to keep this channel warm.

Do you have any national security concerns?
We do have a standing army in a certain limited way. But we do not have major political and territorial problems with our neighbors, China and Russia.

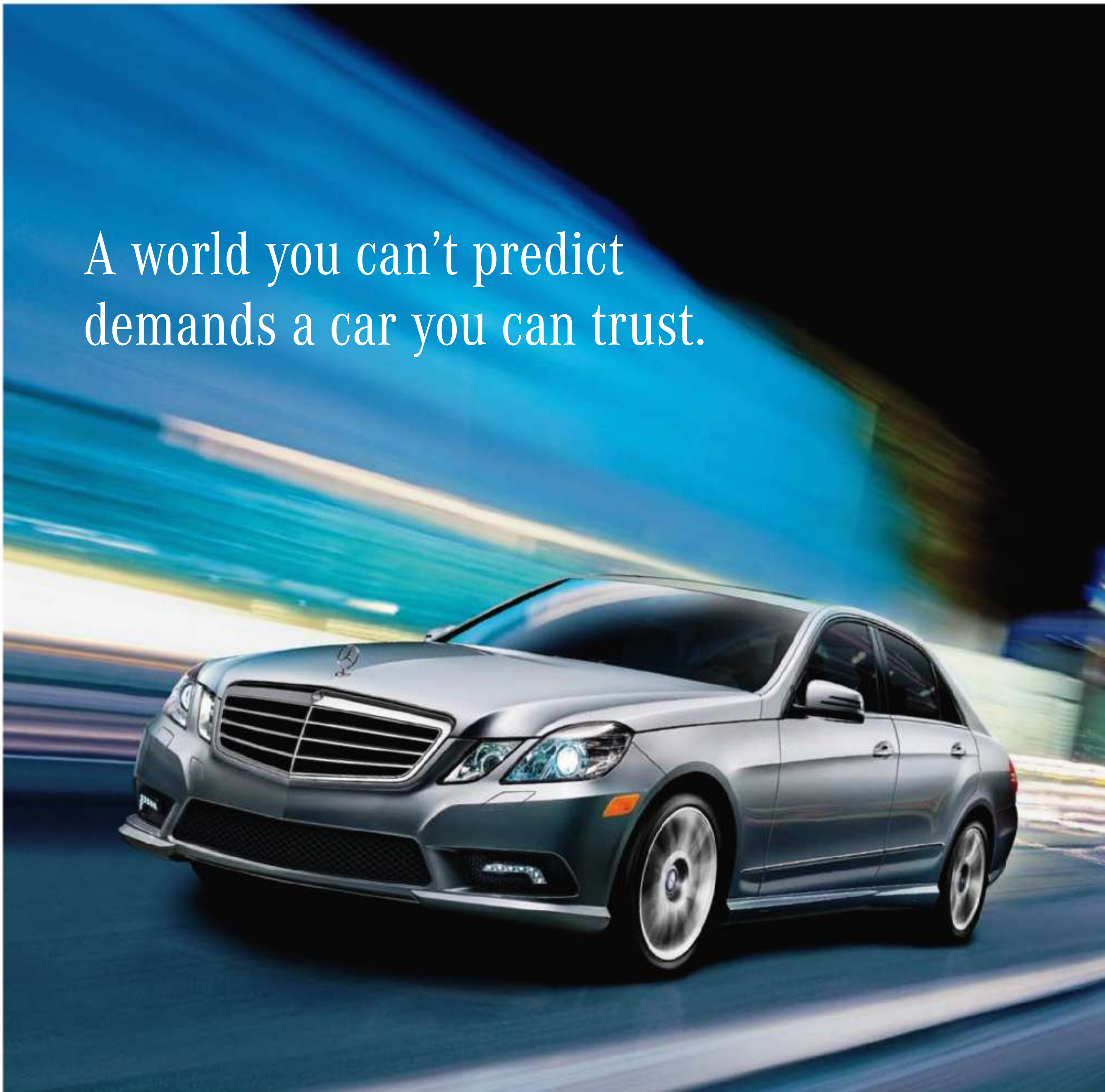
So when you're not running the country, what's the most fun thing to do in Mongolia?
For me, the fun is probably sports. I like playing basketball and tennis. The fantastic thing is to go out to the countryside and see how beautiful my country is, how different the landscape is because it's a vast land. This is one of the most untapped and wildest countries in terms of nature. On top of that, we still maintain the traditions of our nomadic culture.

Any golf courses over there?
Yes, we have one.

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Global Economics

their counterparts in the U.S. While the New York City government is pushing to extend the city's smoking ban in indoor workplaces to public parks and beaches, many of Japan's restaurants don't even have nonsmoking sections, and government buildings still include smoking rooms.

The Institute for Health Economics and Policy, a nonprofit health-care research group, estimates the total cost to society from smoking was 4.3 trillion yen in fiscal 2005, including fees for smoking-induced illnesses, lost productivity, and fires started by lit cigarettes. The Finance Ministry, the majority shareholder of Japan Tobacco, estimates that the tax will raise 1.97 trillion yen this fiscal year.

Naoko Ogata, a senior researcher at the Japan Research Institute, predicted before the tax went into effect that last-minute purchasing of cigarettes in August and September would boost consumer spending by 0.2-to-0.6 percentage points in the third quarter. With consumer spending accounting for about 60 percent of the nation's economy, that results in a 0.5-to-1.4 percentage-point increase to annualized growth in gross domestic product. Japan's economy will expand at a 1.7 percent annual pace in the three months ending Sept. 30, according to 15 economists surveyed by Bloomberg.

Much like the temporary lift one gets from a cigarette, the economic gain from tobacco hoarding, as well as government financial incentives for Japanese car buyers that expired at the end of September, likely will prove fleeting. "With the cigarette tax and the end of the subsidies, we're going to see a huge surge this quarter, followed by an unbelievable drop the next," says Azusa Kato, an economist at BNP Paribas in Tokyo.

It may take additional increases in tobacco taxes to lower smoking rates in Japan, researchers suggest. Some 10 percent of smokers in a survey by the Kansai Institute for Social and Economic Research said they would stop smoking if the price of a pack of cigarettes became 50 yen higher, and half said they would quit in the face of a 200 yen increase. —*Aki Ito*

The bottom line *Japan's economy probably got a temporary lift in the third quarter from a spike in tobacco sales ahead of a big tax increase.*

Seven Days

Events of note in the week ahead

by Ira Boudway

04

U.S. manufacturing orders and pending home sales for August

New York Equity Options Conference



▶ **Asia-Europe Meeting:** Heads of state and other leaders from 48 countries gather in Brussels for biennial talks on trade and strategic relations.

05

Turner Prize exhibition opening at Tate Britain

European Commission quarterly report on the euro zone



▶ **World Business Forum:** Al Gore, Joseph Stiglitz, and Jack Welch speak at the annual New York event.

▶ **Yum! Brands earnings report:** Fast-food company expected to report it's on track for 12 percent annual growth.

06

Paul Volcker at the Canadian Economic Forum in Toronto

Earnings reports from Marriott and Monsanto

▶ **Costco Wholesale earnings report:** The warehouse club has cut prices to gain market share during the downturn. Analysts expect a 15 percent jump in fourth-quarter earnings.



07

Sarah Palin at Faulkner University in Montgomery, Ala.

PepsiCo earnings report



▶ **September retail sales:** Clothiers including Abercrombie & Fitch, Gap, and Target report monthly numbers.

▶ **Alcoa earnings report:** Wall Street expects lower profit after near-record inventories curbed aluminum prices.

08

Russia's Consumer Price Index and consumer confidence

▶ **U.S. unemployment rate:** The private sector added 67,000 jobs in August as the jobless rate rose slightly, to 9.6 percent. A Bloomberg survey of economists forecasts 9.7 percent unemployment for September.

09

Twenty years ago: David Souter sworn in as a U.S. Supreme Court Justice



▶ **Euro 2012 soccer:** The Romanian national team travels to France, and Croatia visits Israel in the qualifying round for the European Championship.

10

Bank of America Chicago Marathon

Workers' Party Foundation Day in North Korea



▶ **Obama in Philadelphia:** The President holds one of four midterm rallies for the Democratic Party. Swing states on the itinerary: Wisconsin, Ohio, and Nevada.



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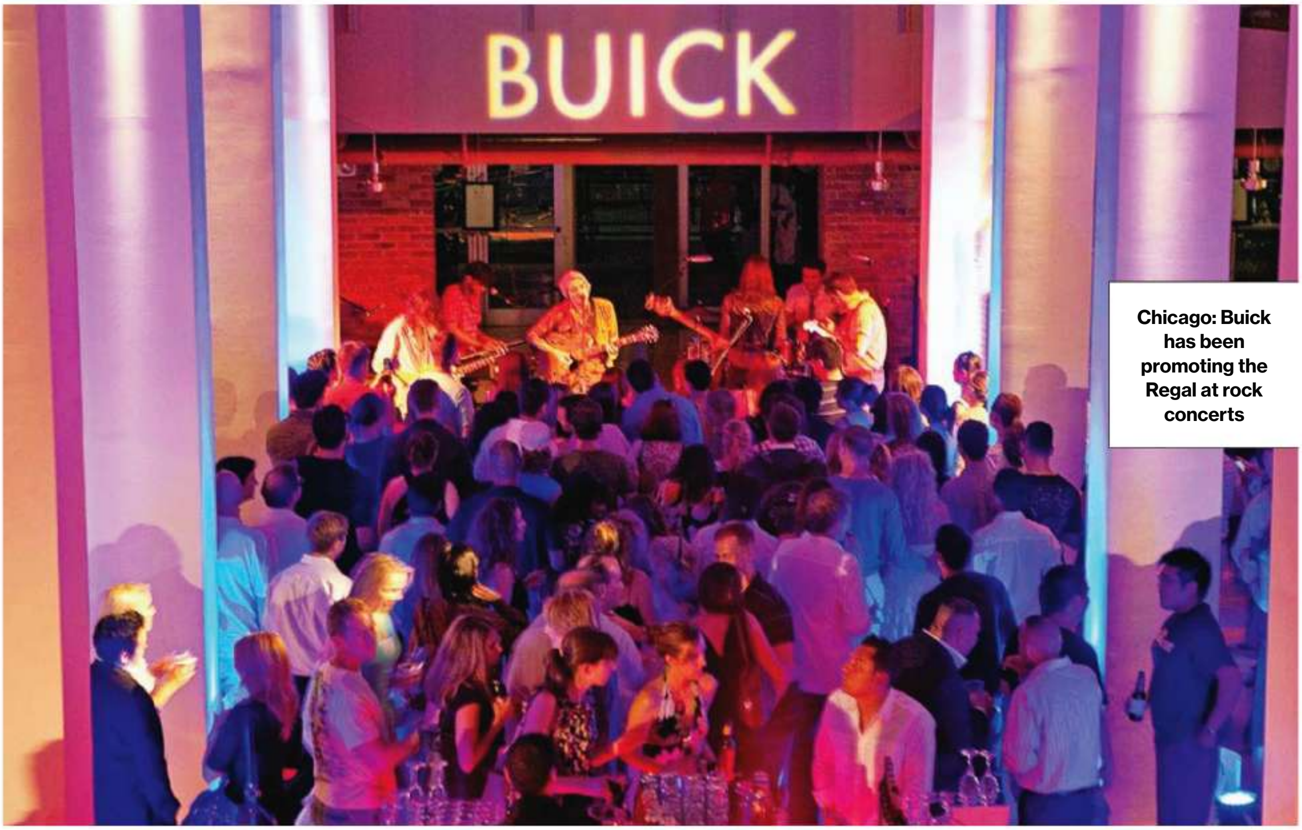
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Chicago: Buick has been promoting the Regal at rock concerts

For Buick, Signs of Life Beyond the Retiree Market

▶ **The GM brand, a mainstay of elderly drivers in the U.S., is suddenly on a roll**

▶ **"These cars are succeeding because of the product, not the brand labeled on them"**

To understand Buick's startling comeback from its near death in the U.S. about 15 months ago, talk to Darrell Bostic. The 33-year-old Navy man in Corpus Christi, Tex., just bought his wife a new Lacrosse sedan after ruling out a Toyota Camry and a Nissan Maxima. Bostic and his wife are in their 30s and have young children. They are a very different demographic from the 70-year-olds who typically have embraced Buick—in declining numbers—for decades. But then the Lacrosse is not what Bostic had come to expect from Buick. The new midsize sedan, released last year by the **General Motors** unit, sports a sharply sculpted body quite unlike the land barges of its past. Inside, the car has such youth-friendly technology as iPod connectors and a 40-gig hard drive in the dash. "Buicks are known for being for older people," Bostic says. "The cars were big, long, and not really stylish. The look of this car really got us."

The Lacrosse's more adventurous styling is a big reason why Buick sales are up 60 percent this year. That's made it GM's fastest-growing brand in the U.S.—not bad for a car division that advisers hired by the Treasury Dept. briefly considered killing when the automaker was in bankruptcy last year.

Buick has long been a hot car brand in China, where three times more Buicks are sold than in the U.S. In America the average age of Buick owners three years ago was 72. Its recent rebound has surprised even GM marketers. The Lacrosse and Buick's Enclave SUV caught fire with consumers, even while brand managers still are formulating exactly what a revived Buick's image ought to be. For now, Roger G. McCormack, Buick's product director, just describes it as "approachable luxury." The cars offer more



The new Buick Regal

styling and luxury features than basic brands like Chevy and Ford but for less money than true luxury brands, he says. When asked to explain the brand's progress, McCormack says simply: "It's product-driven momentum."

At least Buick knows what it doesn't want to be. For years, its stuffy image was built on big cars, so much so that in his 1977 film, *Annie Hall*, the character played by Woody Allen says, "There's a spider in your bathroom the size of a Buick." That's changing. The new Lacrosse is about the size of a Toyota Avalon, not a Cadillac of old. The just-launched Regal, plucked from GM's European unit, is a few inches shorter than a Honda Accord. Buick plans to put out a compact in about two years. And with interest in the brand so high, GM is even thinking about bringing a small SUV to the Buick line and is looking for other cars in its global portfolio.

Given increased interest in its cars, Buick wants to update its customer base. After years of courting the country-club crowd with Tiger Woods as a sponsor and its own major golf tournament, the Buick Open, Buick cut ties with both over the past two years to save money and focus on a younger demographic. "Golf can be a part of it," McCormack says. "It's just not the primary focus." In its place, Buick today advertises in culinary and travel magazines.

Buick marketers have been touting the new Regal at rock concerts called Regal Remixes, featuring local bands. It held events in Dallas, Chicago, and San Antonio this summer. "When people think of Buick, they don't know what to think," says Jeremy Anwyl, chief executive officer of auto website Edmunds.com. "These cars are succeeding because of the product, not because of the brand labeled on them." That can create confusion, but cruising away from its septuagenarian image can only help, he says. "It's better than where they were."
—*David Welch*

69
YEARS

Average age of Buick owners. Buyers of the Lacrosse are 10 years younger

The bottom line *Buick, a brand long favored by the elderly, is on a roll because of hot new cars. Now owner GM is trying to expand its customer base.*



Shoprite has stores across Africa, including this one in Lusaka, Zambia

Mergers

Africa Looks Like a Dealmaker's Paradise

▶ Wal-Mart isn't the only company doing deals in Africa

▶ A wake-up call "that Africa is popping up on the radar screens"

For much of the past decade, Asia has been the go-to continent for companies interested in tapping into fast-growing economies. Now, **Wal-Mart Stores**' agreement on Sept. 27 to buy South African retailer **Massmart Holdings** for $4.6 billion may signal a shift toward Africa as another dealmaking destination for multinationals. Besides the Wal-Mart acquisition (the U.S. retailer's largest in more than a decade), **HSBC Holdings** is in talks to buy a controlling stake in **Nedbank Group,** South Africa's fourth-largest bank, and Japan's **Nippon Telegraph & Telephone** is buying Africa's biggest technology company, **Dimension Data**. In all, more than $15 billion in deals have been announced across Africa since July.

Big purchases like Wal-Mart's "were a wake up to the rest of the world that Africa is popping up on the radar screens," said Aly Khan Satchu, a Nairobi-based independent investment analyst. Adds David Shapiro, head of Sasfin Holdings' securities unit in Johannesburg: "Any deal is possible."

A growing number of companies from the U.S., China, Japan, and Britain are eager to tap the potential growth of a continent with 1 billion people—especially given the weak outlook in many developed nations. (On Sept. 21 the International Monetary Fund raised its 2010 growth forecast for South Africa to 3.2 percent, from 2.6 percent.) Meanwhile, African governments are luring investments from Chinese companies seeking to tap the world's biggest deposits of platinum, chrome, and diamonds.

The Wal-Mart deal has drawn attention to the African retail sector. South Africa's **Shoprite Holdings**, the continent's largest food retailer with more than 1,000 stores in 17 countries, and **Pick n Pay Stores** could now draw bids from big European retailers **Carrefour** or **Tesco**, figures Stephen Carrott, a Johannesburg-based analyst at Macquarie Group. Shoprite, which has 124 supermarkets on the continent outside South Africa and plans to add another 20 in Nigeria over the next two years, is an "excellent" potential acquisition, he says.

Another company in the spotlight is **Bidvest**, which gets 57 percent of its revenue from southern Africa. With businesses ranging from auto dealerships to financial services operations, "Bidvest is a prime target for African growth," says Wayne McCurrie at RMB Asset Management in Johannesburg. Simon Hudson-Peacock, head of specialist equities at Cape Town-based Cadiz Asset Management, says Bidvest's food and catering assets could catch the attention of an acquirer such as **Sysco**.

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Will the NLRB deflate the protest rats? page 34 ▶

Barloworld, which sells machinery made by **Caterpillar,** is "nicely exposed to Africa," says McCurrie. He adds that South Africa's largest food company, **Tiger Brands**, is a "good play" for international companies with the view that people spend more on food as their nations get richer.

With as much as a third of Africa's population carrying mobile phones, analysts believe companies such as India's **Bharti Airtel** will seek other markets to gain a foothold. Bharti this year spent $9 billion to purchase the African assets of Kuwait's **Mobile Telecommunications**, giving it access to 15 African markets, after failing in merger talks with South Africa's **MTN Group**, the continent's largest mobile-phone operator.

Foreign companies likely will rely on South Africa, the continent's biggest economy, as a springboard into markets such as Kenya and Nigeria. South Africa is like the "head office for the rest of Africa," Shapiro says.

—Renee Bonorchis, with Eric Ombok

The bottom line *In the wake of $15 billion in African takeover deals since summer, more global companies are expected to buy into the continent.*

Retailing

With Stores Nationwide, Macy's Goes Local

▶ **The big department store chain caters to regional tastes**

▶ **"How do you do that with 810 Macy's stores?"**

This holiday season, the shelves will be chock-full of Elvis Christmas tree ornaments at **Macy's** stores across the Memphis area, where local shoppers just can't get enough of the King. In Minneapolis, however, an electric *krumkake* baker—used to make those tasty cookies prized by locals of Scandinavian descent—is expected to be a hot seller. And in the chain's Brooklyn (N.Y.) stores, the Imusa cookware popular in many Hispanic kitchens will be displayed prominently. It's all part of Macy's strategy to tailor store merchandise to individual markets, making the giant retailer appear smaller and in touch with local shoppers.

For the holidays, the nation's second-largest department-store chain is introducing 2,200 local-themed tree ornaments as part of its "My Macy's" program, an initiative begun in 2008 to better customize merchandise year-round. Some 1,600 district managers, who oversee goods categories in no more than 12 stores each, select the items.

Going local could pay off big. "My Macy's" may add as much as 3 percentage points to the chain's holiday sales at stores open at least a year. Sales will probably increase as much as 5 percent in 2010 after three years of declines, figures Citigroup analyst Deborah Weinswig. And focusing on merchandise tied to, say, the Chicago Blackhawks hockey team in Illinois stores spurs other purchases by making Macy's more relevant to area customers, says Chief Executive Terry J. Lundgren. "We had to do something different," says Lundgren, 58. "I wanted to maximize the business on a local level. But how do you do that today with 810 Macy's stores?"

Lundgren hatched the "My Macy's" idea when consumer spending began to slow three years ago. Since then the company has directed tens of thousands of specially chosen items to local markets, says Jim Sluzewski,



a Macy's spokesman. The department store's managers, for instance, identified strong demand for size 11 women's shoes in Chicago, formal wear for boys in Salt Lake City, locally made Sanders chocolate candies in Michigan, and coffee percolators on Long Island (where the retailer sells more of the 1960s must-haves than anywhere else in the country). Carolina Sekkel, an Arlington (Va.)-based district planner for 12 stores, says the process identified demand for separately sold pieces of women's suits in Washington, D.C. Increasing the selection of separates, which allow female shoppers to mix and match clothing sizes and buy off the rack without having to do alterations, has helped generate "double-digit" sales gains in percentage terms, Sekkel says.

Wendy Liebmann, CEO of WSL Strategic Retail, says that kind of strategy can generate sales throughout a store by developing customer loyalty and boosting frequency of visits. It also helps raise profits by reducing irrelevant and excess inventory that then has to be discounted, allowing "My Macy's" to "punch above its weight," she says.

In creating the "My Macy's" plan, Lundgren drew on his experience as a china buyer for the former Bullock's chain in the 1970s. He says he was so close to the 18 Southern California stores he supplied that he would transport sets of Lenox plates in his car trunk to stores that ran low. He was named CEO of Macy's predecessor, Federated Department Stores, in 2003. Two years later he spearheaded the $17 billion acquisition of May Department Stores, which doubled the size of the company.

After renaming the combination Macy's, Lundgren consolidated seven regional buying offices into one national center in 2008 and 2009. Abandoning his one-size-fits-all merchandising policy for his new megaretailer, Lundgren divided up the company's store locations into 69 local districts. Today, district managers oversee merchandise in almost half as many stores as they used to, giving them more time to interact with shoppers in each and to better gauge local tastes, he says.

5%

Projected Macy's sales increase in 2010, according to Citigroup

Salesclerks record local requests from shoppers in log books to pass on to the district managers, who then electronically make about 1,000 requests to the main office each week for a customized mix of merchandise for their stores. Headquarters approves about 90 percent of the pitches, usually within seven days, Sluzewski says. Initially, top-level buyers resisted what district managers wanted to buy, Lundgren says. He also faced skepticism that a single buying office could supply everyone's needs. "This was a major cultural shift for the company," Lundgren says. "The hardest part was that not everyone could come along." (Implementing the divisional consolidation last year led to about 1,900 job cuts.)

Those still around have embraced their buying power. In Orlando, shoppers are now offered more twin bedding at stores near condominium rentals, and during peak vacation months, Latin American tourists can find the Nespresso coffee machines they covet, says Meredith Mescher, a home goods district merchant. "You can make a decision in a snap," she says. "It tells our sales associates, there is someone here to help them drive sales and, at the end of the day, this is what it is about."
—*Cotten Timberlake*

The bottom line *Department store giant Macy's looks to raise profits by allowing local managers to customize the merchandise mix in their stores.*



Mergers

Why Southwest Air Is Bulking Up

▶ By buying AirTran, the discounter hopes to revive its growth

▶ "Southwest is saying it is no longer the airline of Ma and Pa"

Throughout its history, **Southwest Airlines** prospered from organic growth, betting that its competitive labor costs, low fares, and unique corporate culture comprised the best arsenal against rivals. Yet with the U.S. air travel market stagnant and larger airlines consolidating into more dominant competitors, Southwest has been forced to rethink its traditional business model in recent years. The latest change came on Sept. 27, when the Dallas-based airline agreed to pay $1.4 billion to buy AirTran Airways, a unit of **AirTran Holdings**. The acquisition, only the third in Southwest's history, would give the discounter its first service in Atlanta, a **Delta Air Lines** fortress for decades, and more flights from New York and Washington D.C. "Southwest is saying it is no longer the airline of Ma and Pa—we are going to become the airline of the business person," says Alan Bender, a professor at Embry-Riddle Aeronautical University.

The deal will make Southwest a truly national discount airline and

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remove it further from its beginnings flying three planes between three Texas cities. With service to new secondary markets such as Wichita, Bloomington, Ill., and Huntsville, Ala.—plus additional cross-country options—Southwest will be better poised to capture more higher-paying business passengers. "The [network] holes are now officially plugged, and it is truly impressive what they've built here," says William S. Swelbar, a researcher at MIT's International Center for Air Transportation.

Analysts say Southwest had little choice but to pursue new business by buying a rival. Having already expanded its route map to 69 airports in 35 states, internal growth in a down economy was no longer an option. Southwest had no way to expand at a key business airport like New York LaGuardia or to break into Washington-Reagan and Atlanta because of facility constraints. Worse, domestic air travel—Southwest's sole source of business—has contracted in recent years amid America's lingering economic weakness. One result: The carrier posted a $120 million loss in the third-quarter of 2008 (its first in 17 years) and has lost money in four of the past eight quarters. "We are not willing to make a bet on the economy or operating costs coming down," Chief Executive Officer Gary C. Kelly says. "And that naturally leads us to having a more energetic focus on 'Well, then how do we grow?' Fortunately for us we found a situation that lets us do that."

The Southwest-AirTran deal was announced less than a week before **Continental Airlines** and **United Airlines** were expected to close their merger, creating the world's biggest carrier. As part of the concessions needed to gain regulatory approval for that tieup, Continental ceded landing slots to Southwest at Newark, giving Southwest its first flights at the capacity-constrained New Jersey airport. The Continental-United combination will push that airline ahead of Delta, which claimed the title of biggest only two years ago by acquiring Northwest. Kelly denies that the consolidation movement played much of a role in his decision to call AirTran Chairman and CEO Robert L. Fornaro last spring to broach the topic of a deal. He does allow that "two of our legacy competitors have become stronger recently, and we'll need to reflect on that." However, Kelly adds, "to say that because four airlines have become two is the reason we are doing this deal would be grossly inaccurate. But I will admit the acquisition will make us more competitive."

It will also put the company even more squarely in the sights of Delta, which turned Atlanta into the world's busiest airport with the "hub-and-spoke" system of funneling passengers to their destinations. In July, Delta and its regional affiliates controlled 76 percent of passenger traffic at Hartsfield-Jackson Atlanta, according to figures from the airport. AirTran's market share was 17 percent the same month. To Kelly, that signifies a high-fare environment ripe for Southwest service. "We need more flights on a combined basis [in Atlanta] than AirTran has today," he says. "And I do mean significantly more flights—more than a couple." Such a move could spark a fierce response from Delta, akin to a "defend the fortress hub strategy," as Hudson Securities analyst Daniel McKenzie wrote Sept. 28 in a note to clients.

Southwest has already made a few decisions on integrating the two airlines: It will scrap AirTran's $20 checked-bag fee, assigned seat-

Quoted

"I am one of four girls and was inspired by my father to dream big. Some girls want to be doctors, but I wanted to run a company."
—Denise Morrison, after being named CEO heir-apparent at Campbell Soup, on her lifelong dream to lead a business







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ing, and two-class cabins, while keeping that airline's 86 Boeing 717s. Adding the smaller jet will require new crew scheduling and maintenance protocols, adding complexity to its time-honed operations. The airline will also acquire its first international flights through AirTran's existing service to Aruba, Cancun, the Dominican Republic, and Jamaica. "We want to have greater appeal to more customers nationwide," Kelly says. "We are at the point where we can think that way after 40 years." *—Justin Bachman, Mary Schlangenstein, and John Hughes*

The bottom line *In a bid to continue growing and lure more lucrative corporate travelers, Southwest Airlines is paying $1.4 billion for AirTran.*

Motorcycles

Harley Shows Its Feminine Side



GEORGE FREY/BLOOMBERG

▶ **The vaunted maker of street rides looks to women to rev up growth**

▶ **"Here's a Victoria's Secret model riding bikes and doing burnouts"**

On a stormy Tuesday night in late September, Linda "Jo" Giovannoni was busy making preparations for a women-only "garage party" at the Palatine (Ill.) dealership of **Harley-Davidson**, a company best known for its big motorcycles that appeal primarily to aging white males. That evening Giovannoni, marketing director at the suburban Chicago dealership and a co-founder of *Harley Women* magazine, was out to change that perception among the dozen or so women who showed up to share snacks, overcome fears, and talk cycling. Giovannoni led the women on a tour of the showroom, crowded with $15,000 bikes, and gave them advice on essentials such as how to fit a helmet and the proper accessories to customize their rides. One partygoer, 55-year-old Jo-Ellen Douglas, had ridden with her husband for years. "I was just happy to be on the back," she said. "Now I've decided it's my turn."

Harley, still reeling from the weak economy, has increased female-targeted marketing this year to attract more would-be riders like Douglas. In July it introduced the $8,000 SuperLow, designed to appeal to women and first-time riders. The SuperLow has the lowest seat in Harley's 32-bike lineup, making it easier to ride, and it's 150 pounds lighter than a typical Harley.

A bike more suited to women is something Harley customers have long been asking for. Chief Executive Officer Keith Wandell saw that firsthand at a riders event in Orlando on his first day on the job in May 2009. "Ten questions were asked and nine of them were from women, and all of them were really asking the same thing: When are you going to design a bike that's more suitable for women riders?" Wandell recalls.

The company certainly needs additional sources of growth. New motorcycle registrations have fallen 41 percent since 2007 overall and 36 percent for Harley. The company's production has sunk to 2001 levels. And about a fifth of the bikes Harley ships today are Sportsters, the smaller, less expensive (and less profitable) models. To help address declining volume and product margins, Wandell spent his first 19 months in office reworking labor contracts at Harley's plants. The new agreements give new employees fewer benefits and let the company add and cut workers based on demand. Wandell also got rid of non-Harley bike brands such as MV Agusta and Buell to focus on its namesake icon, which traces its roots to 1901.

Women riders now represent about 12 percent of Harley sales compared with 2 percent in 1995. The brand also has a 53 percentage-point market-share lead among female riders and has the leading share for people aged 18 to 34, Hispanics, and African-Americans, other groups it's courting, the company says, citing researcher R.L. Polk's data.

Harley-Davidson has 47 percent of the U.S. market share for on-road motorcycles through July, a one percentage point increase from last year, according to Polk. **Kawasaki Motors** is second, with 14 percent.

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Companies&Industries

To help attract women, Harley in 2008 hired Marisa Miller, who has modeled for Victoria's Secret and *Sports Illustrated*'s swimsuit edition, as a spokesperson. In addition to appealing to men, Miller, whose riding skills can be seen on YouTube, helps Harley draw female riders, Wandell says. "It says, look, this is real stuff," he says. "A lot of women ride bikes, and here's a Victoria's Secret supermodel riding bikes and doing burnouts. It was strictly intended to send that message." The marketing effort, part of a doubling of spending since 2007, complements the introduction of the SuperLow, which, in addition to black and other traditional Harley colors, comes in Merlot Sunglo.

Harley and its dealers are also working to overcome some women's apprehension about safety. A few evenings a year, many of Harley's 650 U.S. dealers close their stores to men and hold women-only parties where staffers try to demystify a 700-pound motorcycle. The company held about 500 such events in March, attracting 27,000 women, 11,000 of whom were in a Harley dealership for the first time. The company says it sold 3,000 bikes from the events that month.

Turning age 50 brought Joanne DeGennaro, an office administrator for an orthopedic surgeons' group, to Giovannoni's garage party near Chicago last month for her first time on a bike. "I had been conservative and in a career where I've seen very bad injuries from these types of things," she said. "I have no idea what I'm doing. I mean the weight of it just intimidates me, you know?"

That night, however, she was able to sit on one of Harley's smaller bikes, a Sportster, with salesman Mike Parth showing her that it's easier to lift the 550-pound bike off its kickstand by turning the front wheel to the right. She said she now plans to sign up for Harley-Davidson's training class and get her license. "Considering the type of work I'm in, I'm apprehensive because I see the gooey stuff that we fix from these accidents," she said. "But I just decided, you know what, I've got to start living for myself." Ⓑ —*Mark Clothier*

The bottom line *With motorcycle sales in a slump, Harley-Davidson is boosting its efforts to attract more female riders.*

Briefs

by Caroline Winter

Michelin
A surprise share sale



The world's No. 2 tiremaker on Sept. 28 announced a $1.6 billion share sale to finance its global expansion. Investors, who were surprised by the news, sent Michelin's stock tumbling in Paris trading—the 10 percent drop was the largest the company registered in 12 years. Proceeds from the rights issue will be used to fund construction of new factories in emerging markets, such as India, Brazil, and China, where tire sales are growing by an average 9 percent a year, compared with 2 percent in mature markets such as Europe and the U.S. Michelin's first-half net income reached $687 million, compared with a $166 million loss the year before.

Toys 'R' Us
Gearing up for the holiday season

New Jersey-based Toys 'R' Us, the world's biggest toy retailer, plans to hire some 45,000 employees—essentially doubling its domestic workforce—to cope with holiday season demand. Roughly 10,000 of the positions will be at the company's 600 or so Toys 'R' Us Express temporary stores. Chief Executive Officer Gerald Storch is stocking up on more toys than last year for the holidays. *Toy Insider*, a consumer shopping guide, anticipates that budget-conscious parents will gravitate to lower-priced electronic toys this season.



Sony, Warner, and Disney
Studios eye a premium movie service

Sony Pictures, Warner Bros., and Walt Disney are in talks with pay-per-view provider In Demand and others about offering a premium service that would let consumers watch new movies on TV without waiting as long as three to four months for DVDs or cable companies' on-demand showings. Disney is also discussing streaming films on Web-linked devices such as Microsoft's Xbox console and Sony's PlayStation 3, say people with knowledge of the matter. The studios' plans may meet with resistance from theater chains, which have raised concerns about cannibalizing ticket sales by shortening the exclusive 120-day window exhibitors have for a typical movie release.

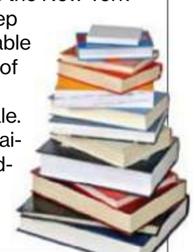
Founder Fund
An incentive for teen entrepreneurs

20
GRANTS

Peter Thiel, a Facebook investor and board member, plans to award 20 grants of up to $100,000 apiece to teenagers with promising tech ideas by the end of 2011. Partners at the Founders Fund, a venture capital firm co-founded by Thiel, will act as mentors. Thiel, who contributed $500,000 to Facebook when Mark Zuckerberg was just 20, wants to "encourage young Americans to take more risks," as he believes traditional education steers them away from entrepreneurship and into everyday jobs.

Barnes & Noble
Investors side with Riggio

Barnes & Noble's shareholders voted to keep Chairman Leonard Riggio on the board of the company he built, rejecting an attempt by dissident investor Ron Burkle to shake up the largest U.S. bookstore chain. Over the past year, Burkle and Riggio have fought for control of Barnes & Noble as the New York-based bookseller tries to keep over 700 superstores profitable amid the growing popularity of digital books. The board is—currently contemplating a sale. Burkle, whose company Yucaipa is the bookseller's second-biggest shareholder after Riggio, may make a bid.



On the Move

NBC Universal Comcast COO Stephen Burke to succeed Jeff Zucker as CEO ● **Live Nation Entertainment** Chairman Barry Diller plans to resign ● **Wal-Mart** Treasurer Charles Holley to become CFO in November

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PROFESSION: PILOT CAREER: ACTOR

People are acquainted with the star, the multi-faceted actor. But John Travolta is also a seasoned pilot with more than 5,000 flight hours under his belt, and is certified on eight different aircraft, including the Boeing 747-400 Jumbo Jet. He nurtures a passion for everything that embodies the authentic spirit of aviation. Like Breitling wrist instruments. Founded in 1884, Breitling has shared all the finest hours in aeronautical history. Its chronographs meet the highest standards of precision, sturdiness and functionality, and are all equipped with movements that are chronometer-certified by the COSC (Swiss Official Chronometer Testing Institute). One simply does not become an aviation supplier by chance.

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▶ The yawning gap between rich and poor 33 ▶ A blow-up over inflatable protest rats 34 ● Edited by Paula Dwyer

Love It or Hate It (Most Do), TARP Didn't Bust the Bank

▶ **The bailout program made money on most Wall Street investments and cost less than expected**

▶ **It's "the best and most useful federal program that has ever been despised by the public"**

Bailed-out banks, insurers, and automakers are a sore spot for millions of Americans hit hard by the financial crisis. Candidates running in November, especially those waving the Tea Party banner, are using "no more bailouts" as their mantra to attract voters. Yet there's a disconnect between the political rhetoric and the facts on the ground.

The Treasury Dept.'s investments in banks through the Troubled Asset Relief Program have done surprisingly well. Lower-than-expected losses on auto and insurance company rescues, as well as the financial markets' return to strength, mean the $700 billion rescue plan launched in October 2008 will cost less than one-tenth its initial price tag. "The TARP may well be the best and most useful federal program that has ever been despised by the public," says Douglas J. Elliott, a fellow at the Brookings Institution and a former JPMorgan Chase managing director.

As Treasury gets ready to shut down the spending phase of the TARP program on Oct. 3, it now expects to turn a $16 billion profit on the $250 billion it plowed into banks in 2008 and 2009. And TARP's final price tag is expected to be about $50 billion, according to an Obama Administration official. The Congressional Budget Office in August had estimated a $66 billion loss. Treasury Secretary Timothy Geithner is expected to brief President Barack Obama on Sept. 30 on the brighter outlook.

"When all is said and done, this program will be viewed as one of the most effective and least costly forms of assistance" in the financial crisis, says Herbert M. Allison Jr., the former Merrill Lynch executive and Fannie Mae official who has shepherded the rescue effort for Geithner and leaves the job on Sept. 30.

$16 BILLION

Expected return on TARP's $250 billion bank investments

Despite the turnaround, TARP remains a political career-killer. Numerous candidates have lost their primaries this year in part because they voted for the bill under President George W. Bush, who urged lawmakers to approve it or risk a global financial calamity.

The victims include Senator Bob Bennett (R-Utah), who lost a May primary to Tea Party-backed lawyer Mike Lee at a state convention where attendees jeered Bennett as "Bailout Bob." More recently, Missouri Secretary of State Robin Carnahan, a Democrat running for the Senate, has taken to calling her opponent, Representative Roy Blunt, "Mr. Bailout" for helping round up Republican votes when the TARP bill was on the House floor. Even Carnahan's brother, Russ Carnahan, voted for the measure as a Democratic member of the House. "Unfortunately, the public hates the banks so much that it cannot accept that a program that did the banks so much good could also have been a real boon to the public," says Elliott.

Now many candidates who won tough primaries are calling for TARP's dissolution. House Republicans vow to cancel the program. Ending it now, however, would have little effect other than to deprive homeowners of getting help, now that TARP's focus is shifting to managing the government's investments, collecting repayments, and preventing home foreclosures. In reality, the program was pretty much shut down in July when Congress passed the financial regulation overhaul. That law bars new spending with TARP money and cuts the program to $475 billion, most of which has been committed.

Out of the rescue's many programs, there are three main sources of red ink: giant insurer **American International Group**, the auto industry, and assistance to homeowners. The Obama Administration for months ➔



FROM LEFT: BRENDAN SMIALOWSKI/GETTY IMAGES; JACK KURTZ/ZUMA PRESS; TED SOQUI/CORBIS; ROBYN BECK/AFP/GETTY IMAGES; DAVID CARSON/ST. LOUIS POST-DISPATCH/AP PHOTO; REBECCA COOK/REUTERS

has been negotiating an AIG exit strategy in hopes of recouping its $182 billion government lifeline and restoring the company to independence. Under the plan, which could be announced as early as Sept. 30, Treasury would convert a preferred stake in AIG to common stock and sell that off next year. The insurer would divest two non-U.S. divisions. The CBO last month projected that $45 billion from AIG's $70 billion in TARP money would be lost. The AIG deal, however, might result in losses of $10 billion or less, the Administration official says. Taxpayers could conceivably turn a profit depending on the market's view of AIG's value, the official says.

Treasury also expects to lose $27 billion on its aid to **General Motors** and **Chrysler**, their financing arms, and their suppliers, out of $82 billion committed to the industry. Some $30 billion dedicated to homeowner assistance was never expected to come back to the government. Geithner's Treasury allocated the funds to banks and loan servicers that modify mortgages and avert foreclosures.

The one program aimed at the distressed securities that originally froze bank balance sheets is likely to be a wash: the Public-Private Partnership Investment Program. Treasury committed $22 billion to help investors buy securities at non-fire-sale prices. The effort is conservatively estimated to cost about $500 million, or less if the funds keep up their strong returns.

Meanwhile, Treasury is raking in money as it reclaims its capital injections into U.S. banks. The biggest names have mostly repaid, each providing Treasury with a tidy profit. After collecting repayments, dividends, and proceeds from warrant sales, the department earned a 14 percent return on the $10 billion it gave to **Goldman Sachs**, and a 13 percent return on its $10 billion to **Morgan Stanley**. **Citigroup** is the lone question mark. Treasury poured $45 billion into the banking giant. So far, $30.5 billion has come back to the government, which still owns 17.5 percent of Citi and is slowly selling that common stock into the market. —*Rebecca Christie, with Hugh Son and James Sterngold*

The bottom line *TARP's bank bailouts are turning a profit, and TARP overall may cost about $50 billion, hardly the boondoggle many pols charge.*

Where did the TARP money go?

$700bn

10/2008: TARP law passes, $700 billion allocated

$475bn

7/2010: The regulatory reform law shrinks TARP to $475 billion and imposes a ban on starting new bailout programs.

$50bn

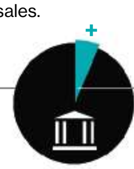
9/2010: The Administration's latest ballpark estimate of losses is an improvement on the Congressional Budget Office's August estimate of $66 billion.

Major TARP Programs

Bank Bailouts — **$250 Billion Committed**

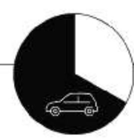
About $200 billion has come back to the government so far, including repayments, dividends, interest, and warrant sales.

Expected Repayments: $250 Billion
Expected profits so far: +$16 Billion



Auto Bailouts — **$82 Billion Committed**

Expected Repayments: $55 Billion
Expected Losses: −$27 Billion



AIG Bailouts — **$70 Billion Committed**

Expected Repayments: $60 Billion to $70 Billion
Expected Losses: −$10 Billion to $0



Housing Bailouts — **$30 Billion Committed**

The funds were never intended to be repaid. They are meant to bail out homeowners by encouraging banks and loan servicers to refinance troubled mortgages.

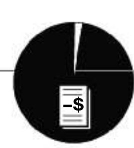
Expected Repayments: $0
Expected Losses: −$30 Billion



Public-Private Partnership Investment Program — **$22 Billion Committed**

Purchases of toxic assets from banks

Expected Repayments: $21.5 Billion
Expected Losses: −$0.5 Billion



DATA: BLOOMBERG



GOP plans to defund health reforms could lead Obama to veto spending

FROM TOP: PETE SOUZA/THE WHITE HOUSE; SUSAN WALSH/AP PHOTO

Congress

Trying to Starve Obamacare

▶ **How Republicans hope to defund health-care reforms**

▶ **"There is definitely going to be a run at it"**

Repealing President Barack Obama's health-care overhaul is a major goal of House Republicans' "Pledge to America," the agenda unveiled on Sept. 23. Total repeal is a long shot, even if the Republicans win control of the House in upcoming midterm elections. So Republicans are preparing a starve-the-beast approach—cutting off taxpayer funds that government agencies will need to issue new regulations and oversee expansion of insurance coverage.

The Congressional Budget Office estimates it will take as much as $20 billion over the next decade to write and support new regulations. The law Obama signed in March provided only $1 billion. Health-care reform is designed to add as many as 32 million people to insurance rolls by 2019.

GOP strategists are already plotting how they can defund health care, starting with sitting on the President's 2012 budget request, due in February. Aides

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to Representative Eric Cantor (R-Va.), the second-ranking House Republican, have carved out other ways they hope to choke off new health programs. Among the targets, they say, is funding for the health insurance exchanges that states are supposed to create so consumers can compare plans and buy coverage.

Also in their sights are the new agency meant to oversee research comparing the effectiveness of treatments and any funds Obama requests to hire federal workers to implement the law. One example: not funding a request for the IRS to monitor tax returns for compliance with insurance mandates. Representative Todd Tiahrt (R-Kan.), a senior Republican on the Appropriations Committee, says defunding is a serious idea. "There is definitely going to be a run at it," he says.

Budgetary brinkmanship involves political risks. If Obama vetoes a spending bill, and Republicans don't blink, the impasse could lead to a government shutdown. When a similar dispute erupted in 1995 between the then-Republican-controlled Congress and President Bill Clinton, the public mostly blamed Congress for the standoff; the Republican Party lost congressional seats in 1996 and Clinton was reelected.

Tiahrt thinks a 2011 shutdown might not play out the same way. The Tea Party's success in fielding candidates in primary races shows growing political support for pushing back big government, he says. The White House contends the Republican strategy carries other risks, including stripping senior citizens of new Medicare benefits and blocking consumer protections.

To Republicans, just talking about withholding funding has advantages: Attacks against health-care reform may well boost turnout among their supporters. Says Robert J. Blendon, a Harvard University professor who directs the school's opinion research program: "Repeal-and-replace is something that's easy to understand if you're an angry voter." *—Alex Wayne*

The bottom line *A House Republican plan to deny funds to Obama's health overhaul could be politically risky.*

Quoted

"It means jobs."

—Michigan's Democratic governor, Jennifer M. Granholm, commenting on Sept. 27 at the White House, where President Barack Obama signed legislation that will cut taxes and provide credit to small businesses



Oversight

The Accounting Board Is a Sinecure Qua Non

▶ The PCAOB has disappointed some reform advocates

▶ "It's one of those positions that is very well paid"

In 2002, Congress sought to make sure publicly traded companies couldn't deceive investors the way Enron did. So it created a watchdog to monitor the accountants that audit the corporations and gave it a gawky name: the Public Company Accounting Oversight Board.

In eight years the board has brought 32 disciplinary cases, only one of which was against one of the Big Four accounting firms. It has also approved six standards governing how auditors must do their work. (Eight others adopted in August await Securities and Exchange Commission sign-off.)

Some of the board's advocates find that slender record underwhelming. "They need to be more forceful in setting the audit standards, and even more importantly, they need to be more forceful in enforcement," says Edward Ketz, an accounting professor at Pennsylvania State University. "It just doesn't seem they are doing enough." Lynn E. Turner, a former SEC chief accountant, says the board is an example of how not to do reform and warns that the new Consumer Financial Protection Bureau must avoid becoming like the PCAOB—a comfortable perch for highly paid bureaucrats hamstrung by political disputes.

The five-member PCAOB offers one of Washington's most lucrative jobs. Congress stipulated that its salaries must be competitive with the private sector. The chairman earns $672,676 a year and board members make $546,891. President Barack Obama, by comparison, makes $400,000, members of Congress get $174,000, and SEC Chairman Mary L. Schapiro receives $165,300.

The board gets little media attention or congressional oversight, having sent an official to testify once in the last three years. The lone case against a major accounting firm came in 2007, when the board fined Deloitte & Touche after a

former partner failed to prevent a pharmaceutical company from overstating revenue. The firm paid $1 million without admitting or denying guilt. "It's not necessarily as taxing as a high-profile, highly scrutinized political appointment," says Cynthia A. Glassman, a former Republican SEC commissioner. "It's one of those positions that is very well paid." The record belies board member Charles D. Niemeier's 2002 pledge that the PCAOB would be "extremely proactive" in setting standards. Niemeier, who has continued to serve even though his term lapsed in October 2008, has one of three seats that Schapiro must fill.

The board's showing isn't entirely its fault. It had been under a legal cloud since 2006, when a Nevada accounting firm sued it, claiming the watchdog wasn't constitutional. That put the board in limbo; the SEC even stopped replacing members whose terms had expired. The Supreme Court rejected the challenge in June, and the ruling set off lobbying by people interested in filling the vacancies.

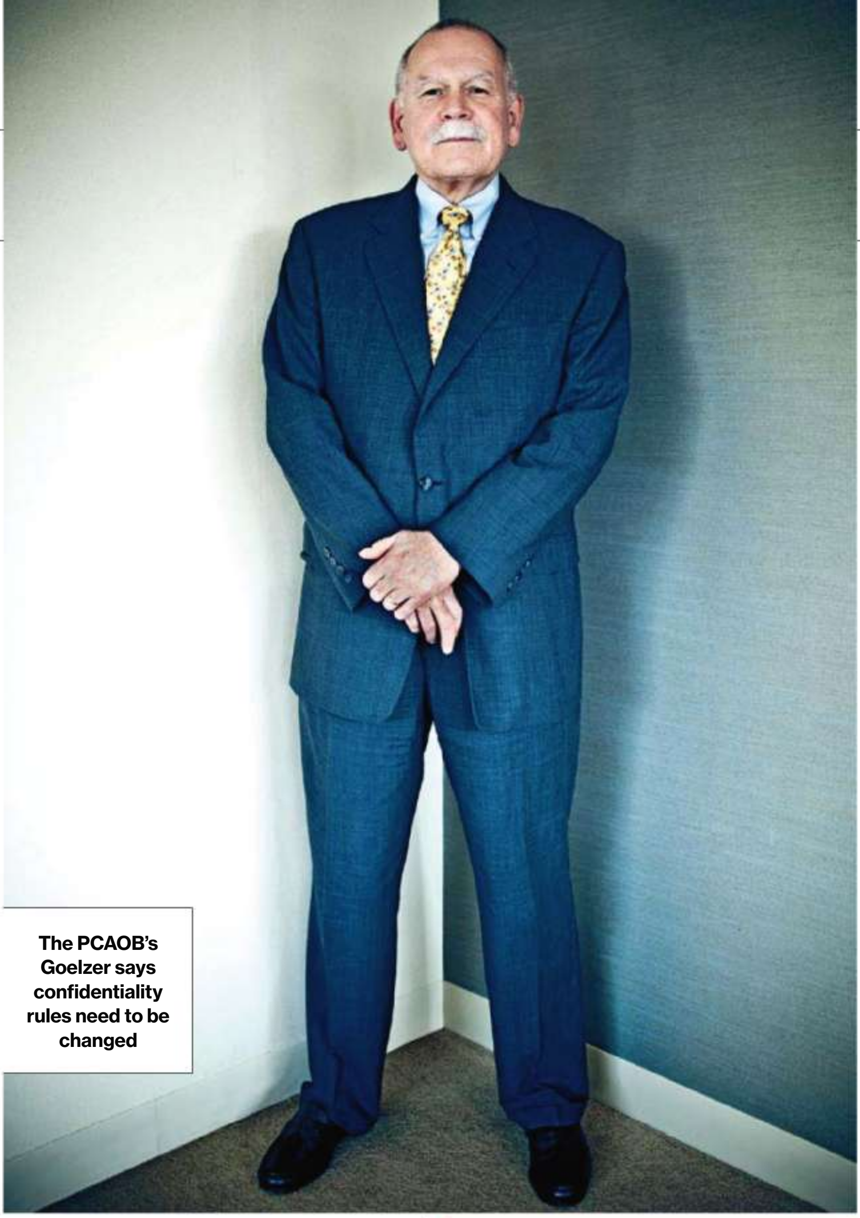
A letter is circulating seeking the backing of securities lawyers for John J. Huber, an attorney with the law firm Latham & Watkins, two people who have seen the letter say. Kathleen Connell, a former California controller, has sought support from business groups for a slot, a senior employee of one of the groups says. John H. Sturc, a Gibson, Dunn & Crutcher partner, has expressed interest in a seat, according to SEC officials. Connell declines to comment. Huber and Sturc did not return calls seeking comment. SEC spokesman John Nester, who would not comment on any names, says the commission "is well on its way" to filling the three vacancies.

A congressional requirement that cases remain secret until they are resolved has also damaged the board, says Daniel L. Goelzer, interim chairman since July 2009. Accountants have an incentive to fight enforcement efforts, he says, because their cases remain confidential as long as they resist. "Nobody who isn't an employee here knows how many cases we've brought or how many have involved Big Four firms," says Goelzer, who wants Congress to change the law.

Mark W. Olson, who preceded Goelzer as chairman, says it's unfair to judge the PCAOB on how many "scalps it puts on the wall" because that's not the regulator's purpose. "There's an extra level of supervision that far exceeds what the industry had before, which was essentially self-policing," he says.

Turner, the former SEC official, sees parallels with Elizabeth Warren, who came up with the idea for the consumer bureau yet is unlikely to head it because of political objections. The PCAOB's first chairman, former FBI and CIA director William Webster, also got embroiled in politics, which prevented the board from meeting its mandate to protect investors, says Turner, who is on a PCAOB advisory panel. "I fear the consumer bureau is suffering the same, and instead of being the crown jewel of the Dodd-Frank bill, will become a cheap zirconium imitation." *—Jesse Westbrook*

The bottom line *Consumer advocates say the accounting oversight board's record is a cautionary tale for the Consumer Financial Protection Bureau.*



The PCAOB's Goelzer says confidentiality rules need to be changed

Elections

State Candidates Catch A Wave of GOP Cash

▶ **Companies hope to influence redistricting and health reform**

▶ **"Democrats are playing defense just about everywhere"**

As companies pour money into the Republican push to gain control of Congress in November, an intense effort to help the party win governorships and state offices has largely slipped under the radar, even though the stakes may be just as high.

One example: **WellPoint** and a subsidiary gave $842,000 to the Republican State Leadership Committee—and nothing to Democrats—for the 2010 elections, IRS filings show. That is almost as much as the more than

THIS PAGE: PHOTOGRAPH BY MELISSA GOLDEN FOR BLOOMBERG BUSINESSWEEK. OPPOSITE PAGE: FRANKIE ANGEL/ALAMY

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OpenTable: Groupon's toughest rival? page 37 ▶



$890,000 the Indianapolis-based insurer gave to this year's congressional candidates. About 70 percent of that money went to Republicans.

Overall, companies have helped Republican committees raise more money for state races in 2010 than they did for Democratic committees. For companies, the state races are an opportunity to elect more Republicans so they have a majority and can control next year's redrawing of congressional districts. WellPoint and other companies also hope to influence state efforts to chip away at President Barack Obama's health-care overhaul. WellPoint spokesmen didn't respond to requests for comment. "The election this time has a more important impact" than in past years, says Paul Smith, a redistricting expert with the Jenner & Block law firm. "And it will be multiplied over future elections" as redistricting can help a party cement gains for many years.

The Republican State Leadership Committee, the party's main fund-raising arm for state posts, has taken in $12.8 million as of June 30, compared with $9.6 million for its Democratic counterpart, according to the IRS. Seventeen of the 20 biggest donors to the Republican committee, whose chairman is Ed Gillespie, a former aide to President George W. Bush, are companies, including **AT&T**, **Wal-Mart Stores**, and **Altria Group**.

The Republican Governors Assn. has also outraised its Democratic counterpart, $58 million to $40 million. One of the most prominent donors: Rupert Murdoch's **News Corp.**, which has given $1 million to help seat Republican governors. "Democrats are playing defense just about everywhere," says Tim Storey, an elections analyst for the Denver-based National Conference of State Legislatures.

Of the 27 legislative chambers Storey says are most likely to change hands, 20 are Democratic-controlled and two, the Alaska Senate and Montana House, are evenly divided. Democrats control 60 chambers to 36 for the Republicans. Democrats also control 26 of 50 governorships, and 37 are on the ballot this year. —*Jonathan D. Salant*

The bottom line *Companies are spending big on state races in hopes of electing more Republican governors and state legislators.*

U.S. Census

The Rich Get Richer ... And You Know the Rest

▶ **Record income inequality could influence the tax-cut debate**

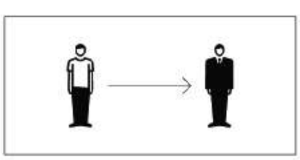
▶ **New data show "there are still people struggling" to stay afloat**

The gap between rich and poor in the U.S. is the widest on record, according to the latest data released by the U.S. Census Bureau. The data, collected in 2009 and early 2010, show the broad impact of the recession, from falling household income and rising poverty levels to reduced birth rates and delayed marriage.

Last year, the top 20 percent of households—those taking home more than $100,000 a year—received 49.4 percent of all household income. The bottom 20 percent—those earning less than $20,000—received 3.4 percent. The top earners' share is up from 49 percent in 2008, while the bottom earner's share fell

How Money Flows to Candidates

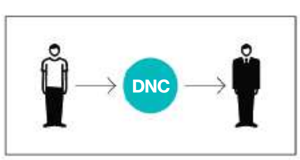
Candidates once relied on political parties, union or corporate political action committees, and individual donors for most of their money. This year's fund-raising features a complex network of interest groups and nonprofit organizations. Below, a primer: —*Jonathan D. Salant*



Transparent

Individual and PAC contributions

Individuals are allowed to give candidates up to $4,800 per election cycle. PACs, often formed by unions and corporations, can give $10,000. Contributions of $200 or more and all candidate spending must be reported to the Federal Election Commission. Democratic candidates have raised $591 million. Republican candidates have raised $603 million.



Semi-transparent

National party committees

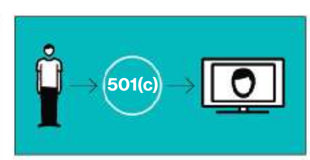
The Democratic National Committee, Republican National Committee, and the parties' House and Senate fund-raising arms raise and spend money for candidates. Individuals can give $30,400 per year. PACs can give $15,000 a year to each committee. The parties report monthly to the FEC. Democratic committees have raised $359 million. Republican committees have raised $323 million.



Semi-transparent

527s and super PACs

527s, named for a section of the tax code, can accept unlimited donations. They can't urge a vote for or against a candidate. Super PACs can accept unlimited donations and endorse candidates. They can't contribute to candidates but can advertise independently. The 527s report to the IRS, super PACs to the FEC. Democratic-leaning 527s have raised $150 million. Republican-leaning 527s have raised $134 million. Super PACs report on Oct. 15.



Opaque

501(c) Organizations

These nonprofit groups, which include the U.S. Chamber of Commerce and the Tea Party-affiliated Americans for Prosperity, can accept unlimited donations and don't have to disclose donors. They must report to the FEC how much they spend on ads that mention a federal candidate. They have reported spending $22 million, mostly in support of Republicans.

DATA: CENTER FOR RESPONSIVE POLITICS, PUBLIC CITIZEN

from 3.6 percent. The ratio of earnings between the top and bottom is almost double what it was when the Census Bureau began tracking in 1967.

Median household income fell 2.9 percent nationwide, from $51,726 to $50,221. Income rose in only one state, North Dakota. The share of Americans below the poverty line (roughly $22,000 for a household of four) rose from 13.2 to 14.3 percent, the highest rate since 1994. Now 43.6 million Americans are living in poverty, the most in the 51 years the Census estimates have been published.

The portrait of growing ranks of poor and a squeezed middle class comes a month before midterm elections and amid a debate between President Barack Obama and Republicans over the status of the Bush-era tax cuts. "It shows that there are still people struggling in the low- and middle-income brackets," says Elaine Maag, a research associate at the nonpartisan Tax Policy Center. "That might be a reason why we would extend the expanded child tax credit [and] the earned-income tax credit assistance" in the Bush tax cuts.

Obama wants to extend tax cuts enacted under President George W. Bush for households earning less than $250,000 and allow them to expire for those above. Most Republicans want to extend the cuts for all income groups. —*Ira Boudway*

The bottom line *Amid a heated debate over expiring tax cuts, new Census data show that income inequality is widening.*



Unions

A Bizarre Blow-Up Over Inflatable Rats

▶ **Why the NLRB may not limit giant protest props**

▶ **"The board is taking ... aggressive positions" favoring unions**

Union organizer Eli Kent says his inflatable rat drew jeers from passersby in Bentleys and Mercedes-Benzes when he set up the 15-foot-tall plastic rodent outside the gates of the **Ridgewood Country Club** in Paramus, N.J., recently. "It's a pretty clear expression of our free speech rights, and it makes a point," says Kent, 34, who is trying to persuade the club's workers to join the Asbestos, Lead & Hazardous Waste Laborers union.

Kent has an unusual job description: Part of his work involves carrying around giant brown rats–along with cockroaches and the occasional coffin–for union protests outside hotels, office buildings, and factories. He transports the critters in a gray Ford Silverado each day to a protest site. His union owns six of the rats, which are made by Chicago-based **Big Sky Balloons and Searchlights** and run from $2,250 to $7,800 apiece.

Thanks to a complaint from a Brandon (Fla.)-based medical center where one of the rats was displayed, the National Labor Relations Board is considering whether these displays should be restricted. Placing these towering rodents in front of a workplace could be considered an unlawful form of picketing by some courts if they are viewed by employees as a signal to leave their jobs. The board in September upheld the right of unions to display two-dimensional, 16-foot banners at picket sites.

A ruling in favor of the bulkier blow-up rats would underscore the agency's shift since President Barack Obama's appointees gained a majority in March, says former NLRB Chairman Peter Schaumber. "The board is taking startlingly aggressive positions aimed at augmenting union power," says Schaumber, who was appointed by former President George W. Bush and is now a labor consultant. The labor panel has also begun exploring electronic-voting methods for unionization elections. Business groups object and prefer that employees cast their votes in person and in supervised secret ballots to shield workers from undue pressure by unions. Labor leaders say Obama has simply restored the board's mandate to protect workers after Bush's pro-management tilt. "The board is doing nothing more than taking a balanced and reasonable approach to the law," says Bill Lurye, AFL-CIO associate general counsel.

The frequent rodent displays outside New York buildings have "gotten a bit old," says Steven Spinola, president of the Real Estate Board of New York. "Clearly, people would prefer they not be there–it can be disruptive because it blocks the sidewalks, and it's a bit embarrassing." That's the whole point, says Kent. Ⓑ —*Holly Rosenkrantz*

The bottom line *Unions' use of giant props is among the many backlogged issues a recast labor-relations board will soon address.*

Drawing Board



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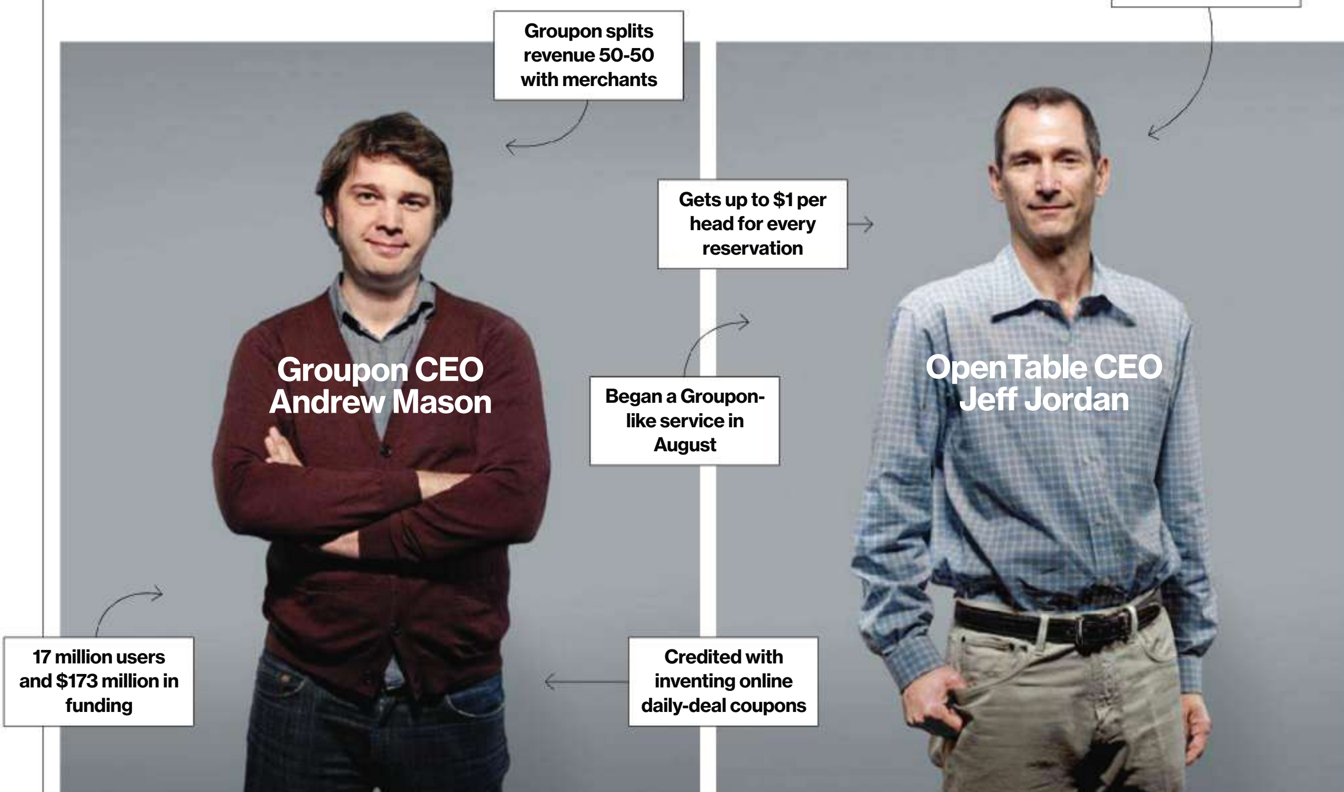
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Technology

Coupon Deathmatch, Party of Two?



▶ Restaurant booker OpenTable may be Groupon's most formidable competitor in online coupons

▶ "This is like the yellow pages business. They are going to need to cover hundreds of cities"

The Essex, on Manhattan's Lower East Side, offers creative cocktails, $1 oysters, and its signature Colorado lamb chops over ricotta gnocchi. On weekday nights and during off-peak hours, it also features lots of empty tables.

To fill his 150-seat restaurant in an economy that can spoil anyone's appetite, The Essex's owner, David Perlman, has turned to Internet coupons. Last spring, he used one of the hottest startups on the Web, **Groupon**, to sell $30 coupons at $15 each to about 1,500 people on the site's New York e-mail list. In August, Perlman went the discount route again, this time with the just-launched coupon service of **OpenTable**, the online restaurant-reservation booker. Slightly fewer than 1,000 people purchased that deal, a $50 coupon for $25. Still, Perlman says he favors OpenTable's service because it brought in gourmet diners who were more likely to turn into repeat customers. "We had a positive, profitable experience with both, but I liked OpenTable better, just because it is more geared toward restaurants," he says. "The people we attracted with OpenTable are people we want to add to our customer base."

Daily deals are everywhere online. That has a lot to do with privately held Groupon, based in Chicago, which has emerged from nowhere to revolutionize local advertising and build a business recently valued at $1.35 billion, according to two people familiar with the company.

Groupon works like this: It sends a daily e-mail to more than 17 million subscribers in over 230 cities, employing flowery prose ("A love of layers may even lead your archeological side through the house lasagna") to offer group discounts on everything from pastries and spa treatments to pilot lessons and restaurant meals. If enough people take the offer and pay in advance, the deal is activated and Groupon splits the resulting revenue 50-50 with the merchant. Subscribers get only one offer per day, which has left room for hundreds of copycats to offer their own variations on the formula. "We stuck a pin in something and now there's a giant eruption," says Andrew Mason, Groupon's 29-year-old founder. "The demand from business owners is much greater than

MASON: PHOTOGRAPH BY JEFF SCIORTINO FOR BLOOMBERG BUSINESSWEEK; JORDAN: PHOTOGRAPH BY GABRIELA HASBUN FOR BLOOMBERG BUSINESSWEEK

Botched foreclosures, longer slump page 44 ▶



anything a single business like Groupon can meet."

Restaurants account for nearly half of Groupon's deals, making OpenTable the imitator best positioned to eat its lunch. OpenTable, started 12 years ago in San Francisco, has put its reservation-management system into more than 14,000 restaurants. (Restaurants either lease computers for a $600 installation fee plus a $199 monthly subscription or they use the cheaper, Web-only option.) It seats about 4 million diners each month. Restaurants pay OpenTable up to $1 dollar per head; diners make reservations for free. The company has the e-mail addresses of tens of millions of gourmands, as well as a sales force devoted to pitching additional marketing services to restaurants using OpenTable. And like Groupon, OpenTable has its own overcooked valuation: Its stock, valued at $1.56 billion, is trading at 72 times its estimated 2011 earnings—more than six times the S&P 500 average.

OpenTable unveiled its Spotlight coupon service in August and has rolled it out in Boston, New York, San Francisco, Chicago, Washington, and Philadelphia. Spotlight is Groupon-like right down to the verbiage. ("Their menus showcase artisanally grown, fresh fare that sings.") CEO Jeff Jordan says Groupon's deals aren't tailored to people's individual interests. "Groupon is sending me ads for hair removal. Nature is doing that for me," he jokes. That lack of focus, he says, has created an opening for him to hone in on foodies.

Groupon believes its size and some upcoming features meant to personalize pitches will keep the competition at bay. It has raised money at a ferocious pace. In April it received a $135 million infusion from two Facebook investors—the Russian-based investment group DST and venture capital firm Accel Partners—and others. Groupon has used the cash to enter new cities, buy competitors in Chile and Germany, and expand its 1,600-person sales force, which makes up about half its head count. The company is beginning to tailor deals to subscribers' location, gender, and any information they volunteer about their buying interests on Groupon's website. It aims to offer deals based on a subscriber's Groupon purchase history, Mason says. (And now it's planning to use that data to help its customers meet: On Sept. 29 it announced the Groupon Date Assistant.)

Analysts are divided on how this coupon contest will play out. "What Groupon lacks in protective competitive moats, I think they get in the fact that this is a scale business," says Scot Wingo, CEO of e-commerce consulting firm ChannelAdvisor. He says the size of Groupon's sales staff is its best competitive advantage: "This is like the yellow pages business. They are going to need to cover hundreds of cities and have feet on the street in all of those places."

72

Ratio of OpenTable's stock price to estimated 2011 earnings

Mark Mahaney, an analyst at Citigroup, downgraded OpenTable's stock in June because he believed the shares were overvalued. He reversed course in September after the company sold 16,000 Spotlight offers in the program's first six weeks, bringing in an estimated $200,000 in revenue. "OpenTable can go right to its customers, all of whom are interested in restaurants," Mahaney says. Groupon and its other imitators acquire most customers either by word of mouth or by running targeted ads on Facebook and Google. Another formidable competitor is also joining the fray: Yelp, the local-business review site, is introducing a daily-deal service. With its 300-strong sales force focused on local ads, Yelp, too, has relationships with merchants.

One clear beneficiary of all this competition will be restaurants. As new entrants undercut each other on coupon commissions, rates could be driven below 50 percent. The coupons are already moving into the upper echelons of gastronomy. Metrazur, a high-end restaurant in New York's Grand Central Terminal, recently sold 1,200 $50 coupons for $25 using OpenTable; Rouge Tomate, another pricey New York eatery, just sold 385 $100 coupons for $50 on Yelp. Perlman, of The Essex, says discounting by the swankiest establishments helps him. "If anything, keeping such company on the deal sites actually enhanced our reputation," he says. —*Brad Stone*

The bottom line *Groupon, which started the boom in daily-deal sites, faces tough competition from similar services offered by OpenTable, Yelp, and others.*

High tech and low cost



To diagnose anemia, a condition that can signal the presence of diseases such as HIV, doctors need a centrifuge to separate blood samples into red blood cells and plasma. Lila Kerr and Lauren Theis modified a salad spinner to do the job in areas without electricity. The Rice University undergraduates created the device as part of their coursework in introductory bioengineering and field-tested it this summer in Ecuador, Swaziland, and Malawi. "The most frequent response" to the gadget, says Kerr, "is 'well, of course!' After all, a salad spinner is a centrifuge." —Ira Boudway

CLOCKWISE FROM TOP RIGHT: ILLUSTRATION BY KATE FRANCIS; ROBERT SCHLESINGER/DPA/ZUMA PRESS; JEFF FITLOW; ILLUSTRATION BY ROSS MACDONALD

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Movies

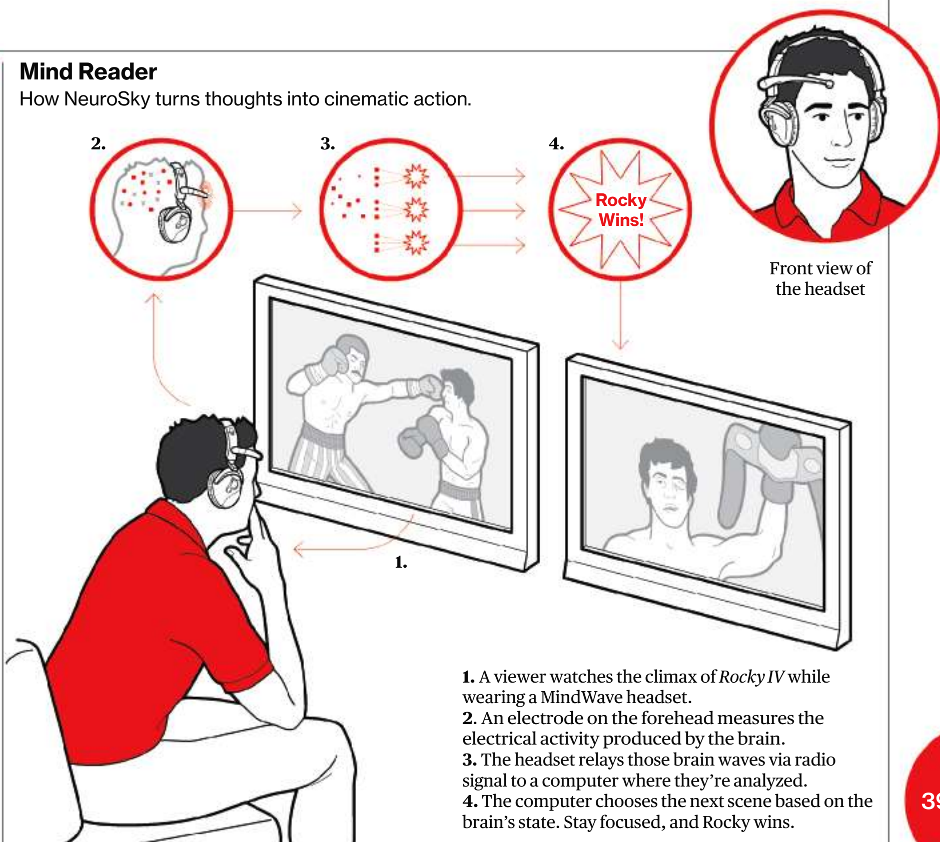
Concentrate, and You Too Can Be Spielberg

▶ Viewers' thoughts influence movie plots with NeuroSky's MindWave

▶ "You're halving your value in some ways" by making two versions

Mind Reader

How NeuroSky turns thoughts into cinematic action.



1. A viewer watches the climax of *Rocky IV* while wearing a MindWave headset.
2. An electrode on the forehead measures the electrical activity produced by the brain.
3. The headset relays those brain waves via radio signal to a computer where they're analyzed.
4. The computer chooses the next scene based on the brain's state. Stay focused, and Rocky wins.

Every Sylvester Stallone fan knows that Rocky Balboa wins the final match against Ivan Drago in the classic 1985 film, *Rocky IV*. But if you were watching the movie while wearing a MindWave headset, the bout could go either way. Concentrate hard enough on the fight scene, and Rocky knocks out Drago. Lose focus, the victory goes to the ruthless Russian.

MindWave is a new device that literally reads minds. Developed by **NeuroSky**, a privately held company in San Jose, Calif., the headset features an electrode that rests on the forehead and detects the miniscule electrical impulses generated inside the brain as it experiences thoughts and emotions. Those brain waves are relayed via a radio signal to a computer, where they're interpreted by specialized software. "My wife and daughter love *Avatar*," says NeuroSky's chief executive officer, Stanley Yang. (SPOILER ALERT) "Every time they watched it they said, 'I wish Sigourney Weaver had lived.' That would be a fun experience if you could see it actually happen because you wished it."

Though James Cameron hasn't come calling yet, curious cinephiles can soon test-drive a MindWave: On Nov. 11, NeuroSky will start selling a $99 kit for use at home. The package will include a headset and a CD-ROM with a brief training program and a short sample video produced by Treite, a London studio. Treite is producing several more short films for MindWave that will be available for download, but the library will be limited for the foreseeable future. "You have to take baby steps first," says Yang.

NeuroSky's technology has been used since mid-2009 in toys like **Mattel**'s Mindflex and **Uncle Milton**'s Star Wars Force Trainer, both of which let kids mentally manipulate a small ball while it floats on a cushion of air. Medical researchers are experimenting with similar systems to allow disabled patients to control wheelchairs, prosthetics, and computers with their thoughts.

When NeuroSky demonstrated the MindWave system for a *Bloomberg Businessweek* reporter, the Treite videos weren't ready, so the company reedited old films, including *Rocky IV*, to create multiple endings. In a pivotal scene from the 1994 hit-man thriller *The Professional*, one of the heroes aims her sniper rifle at a bad guy. The viewer ensures a kill shot by staying relaxed, the ideal mind state for steady hands and accurate shooting. Too much intensity, and the good guy misses.

Yang's aspiration is for movie studios to produce original films tailored for the technology. Ultimately, he hopes, theaters will be able to read the minds of an entire audience, whose thoughts would influence the feature film in progress. Getting to that point is a challenge, in part because theaters would need to purchase headsets and digital projectors capable of picking up radio signals. And, of course, studios would have to film multiple story lines and endings, says Nathan Mayfield, co-founder of **Hoodlum**, a production company that creates interactive games and videos. "You're halving your value in some ways" by creating two versions of the same show or movie, he says.

David Westendorf, NeuroSky's vice-president for marketing, admits that it's a long road to Hollywood success, and it will take at least two years to get a feature film into theaters. "You have to evangelize," he says, "and get the right producers and have the right spitball sessions." —*Michael White*

The bottom line *NeuroSky is trying to bring brain-scanning technology to Hollywood in hopes that studios will create movies with multiple endings.*

Quoted

"Your car should drive itself. It's amazing to me that we let humans drive cars. ... It's a bug that cars were invented before computers."
—Eric Schmidt, Google chairman and chief executive officer



Technology

Advertising

Apple Takes Share from Google in Mobile Ads

▶ Its new iAd network is quickly grabbing market share

▶ As competition increases, "the race by no means is over"

In July the first advertisements placed through **Apple**'s new iAd mobile network began to appear. Marketers use iAd to place interactive banner ads in iPhone, iPod Touch, and iPad applications, including some popular games and the music service Pandora. Apple takes a 40 percent cut while the rest goes to the application's developer.

Over the summer, the consumer goods company **Unilever** used iAd to promote Dove soap and was "extremely happy" with the campaign, says Rob Master, the company's North American media director. When touched, Unilever's banner ad opened onto a library of videos and other content promoting Dove. More than 20 percent of people who opened the ad returned to it a second time, says Master.

Marketers such as Unilever, which is now using iAd to promote Skippy peanut butter, Ragu pasta sauce, and other brands, have helped give Apple Chief Executive Steve Jobs' first foray into advertising a good start. By the end of this year, iAd will pull even with **Google** and account for 21 percent of the U.S. mobile advertising market, according to a forecast by IDC. The market research firm says that Google, the current market leader, will see its share drop from 27 percent to 21 percent. **Yahoo!** and **Microsoft** will sink into the single digits, according to IDC's projections. None of the mobile ad networks report sales figures. Google says IDC undercounts its share and that its mobile ad sales are rising quickly. "If we are losing share, this market is growing faster than any one we've seen," says Jason Spero, director of mobile for Google.

That could well be the case: IDC expects the U.S. mobile ad market to grow by 126 percent this year, to $500 million. By comparison, the online ad market is much larger at $25 billion, but growing at a rate of 11 percent in 2001, according to eMarketer. In recognition of this shift, Google paid $750 million last November to acquire AdMob, then the market leader in mobile advertising. Apple, which had also wooed AdMob, paid $275 million in January for a competitor, Quattro Wireless.

At the iAd launch event in June, Apple said it already had $60 million in commitments from 17 marketers including **Best Buy**, **DirecTV**, and Unilever. The number of brands using iAd has doubled since then, says Natalie Kerris, an Apple spokeswoman. At the network's launch, Jobs predicted iAd would grab half of all mobile-ad spending in the second half of 2010.

One of iAd's strengths is that Apple is able to target ads based on the buying habits of its more than 160 million iTunes users. The iAd network also has some drawbacks that could dampen its future growth. Apple demands a degree of control over the design of the campaigns that some advertisers are hesitant to give, says Noah Elkin, a senior analyst with eMarketer. The iAd network also doesn't allow marketers to target specific devices, such as iPads only. That limitation led Philippe Browning, director of mobile strategy and business development at **CBS**, to opt for AdMob instead of Apple's advertising network.

To stay in the lead, Apple and Google will have to fend off competition from smaller rivals like Jumptap and Millennial Media, which are also gaining market share. On Sep. 27, **Research In Motion** announced plans to start a competing network that will run on its BlackBerrys and forthcoming tablet. "The race by no means is over," says Karsten Weide, a vice-president at IDC. —*Olga Kharif, with Adam Satariano and Brian Womack*

The bottom line *In just a few months, Apple's iAd has captured a large chunk of the rapidly growing mobile ad market.*

2.1

BILLION DOLLARS

The amount Americans are projected to spend in 2011 on virtual goods sold in games such as FarmVille

SOURCE: INSIDE NETWORK



FROM LEFT: ROBERT GALBRAITH/REUTERS; PHOTOGRAPH BY JARED MCMILLEN FOR BLOOMBERG BUSINESSWEEK

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Technology

Tablet Computing

RIM's PlayBook Runs Onto a Crowded Field

- The company says its iPad competitor is tailored for business
- The 50 million BlackBerry users are "the initial low-hanging fruit"

It might be called the PlayBook, but the new tablet computer from BlackBerry maker **Research in Motion** is all about business. "The principal market for this is busy working people," RIM co-Chief Executive Jim Balsillie says.

The device, introduced by co-CEO Mike Lazaridis in San Francisco on Sept. 27, will go head-to-head with **Apple**'s iPad. The PlayBook boasts several features the iPad lacks, including front- and rear-facing cameras for teleconferencing and the ability to play online videos made with **Adobe**'s Flash technology. It's also smaller and lighter, and comes with the same security features that made the BlackBerry popular (and sometimes unpopular) with governments and corporations.

That might not be enough to win in a crowded field. The PlayBook won't go on sale until early 2011. **Hewlett-Packard**, **Samsung**, and **Motorola** are all building similar devices. Apple said in July that 50 percent of Fortune 100 companies are testing the iPad or providing it to employees.

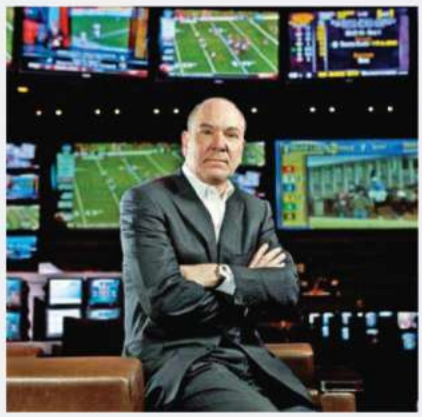
RIM has yet to announce prices and says the first version of the device will access the Web from a Wi-Fi hotspot or by wirelessly connecting through a BlackBerry via Bluetooth technology. Subsequent versions will be able to connect to mobile-phone networks.

Unlike Apple, RIM has no glitzy retail stores to lure new customers. Balsillie said the PlayBook will be sold through carriers and retailers, though he didn't give specifics. Still, RIM has one major advantage in its distribution efforts. "The initial low-hanging fruit for the company is to go after the installed subscriber base of 50 million," says Ashok Kumar, an analyst at Rodman & Renshaw in San Francisco. —*Hugo Miller*

The bottom line *RIM's new PlayBook tablet includes some features the iPad currently lacks but won't go on sale until early 2011.*

Innovator

Lee M. Amaitis



A bond broker brings Wall Street technology to Las Vegas. His insight: Sports bettors don't want to stop gambling after the game begins

It's fourth and one, and the Denver Broncos are going for it. You're certain they'll make it. If only there were a way to bet on this one play. Even in places where sports betting is legal, bookmakers' computers aren't fast enough to handle bets on just one down, at bat, putt, or penalty kick. Once the game starts, betting stops.

Unless, that is, you're in Nevada, where a bookmaker from Wall Street named Lee M. Amaitis offers in-game wagering. Amaitis, 60, is the originator and chief executive officer of Cantor Gaming, an affiliate of interdealer bond broker Cantor Fitzgerald that uses Wall Street-style technology to let sports gamblers scratch their itches. Its In-Running system was launched in March 2009 at the M Resort Spa Casino in Henderson, Nev., where patrons can sit in front of four screens of data looking very much like traders. At The Venetian and The Palazzo casinos in Las Vegas, bets are placed exclusively on a mobile device about the size of an iPad. During the Chicago Bears' 20-17 win over the Green Bay Packers on Sept. 27, gamblers bet on every play as the odds changed. Action is available in seven sports, including golf and soccer. Amaitis claims 15 percent of Nevada's sports gambling market, which the state Gaming Control Board says totaled $1.4 billion in the first seven months of 2010. "We've created a giant price-making technology company and we've applied it to sports betting," he says.

Amaitis is a Brooklyn native who likes the Los Angeles Lakers and Dodgers, though he doesn't bet on them. ("I can't root for a team and then sit down and think about risk management.") In 1995 he joined Cantor Fitzgerald. On September 11, 2001, the terrorist attack on the World Trade Center killed 658 Cantor employees. Amaitis, who ran the London office, returned to New York to help rebuild the company. In 2004 he started working on his gaming operation, getting approvals from Nevada lawmakers and regulators. Four years later he started running the gambling unit full-time.

Cantor Gaming's advantage is speed. Its bookmakers can post odds on new situations as they arise, take in bets, and change the odds to balance its book–that is, ensure that it won't lose much money regardless of the outcome. London-based William Hill, one of the world's biggest bookmaking companies, has nothing like In-Running, says spokesman Graham Sharpe: "We can come up with the odds. The problem is getting them online quickly enough to let people get at them."

Joon Ho Hwang, a gambling economics expert at Korea University Business School in Seoul, likens traditional sports betting to buy-and-hold investing. Says Hwang: "In-game wagering is allowing bettors ... to become quasi-day traders." That's catnip for gamblers. As one In-Running customer told the *Las Vegas Sun*: "I want to be doing something during the game rather than sitting there like a dip." B

—*Peter Coy, with Beth Jinks*

Résumé ▶ **Joined Cantor Fitzgerald in 1995 and helped rebuild it after 9/11**
Teams ▶ **L.A. Lakers and Dodgers—though he doesn't bet on them**
Product ▶ **In-Running, which lets gamblers bet on outcomes during a game**

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Markets&Finance

Individual Investors Duped by Derivatives

▶ **Wall Street peddles complex securities to a yield-hungry public**

▶ **Such a complicated product "raises questions about suitability"**



ILLUSTRATION BY DAVID PARKINS

Leona Miller, an 84-year-old retired beautician, says she was seeking safe and steady income from bonds two years ago when she bought securities recommended by her **Wachovia** broker, Robert Baldacci, paying 9 percent interest. Within six months, Miller lost about 30 percent of her $20,000 investment, and the bonds were converted into shares of **Merck** in a falling stock market. "I just wanted him to make some money for me, like anybody else," says Miller, who lives in San Diego. "I still don't understand too much about it."

Miller had bought a structured note—a bond combined with a derivative. In her case, it was a reverse-convertible note with a knock-in put option tied to Merck stock. The option meant the security could offer a relatively high interest rate. It also added risk, as Miller learned too late. A decline in the drugmaker's shares, to below 32 from 40 when Miller bought the notes, triggered the put option. That allowed the note's issuer, the Oslo-based export-credit agency **Eksportfinans**, to pay Miller off with Merck shares, then trading at 26. Kathryn Ellis, a spokeswoman for San Francisco-based **Wells Fargo**, which acquired Wachovia in 2008, and Baldacci, who no longer works for the bank, declined to comment.

While customized derivatives have been criticized for their role in the credit crunch, securities laws allow them to be sold to individuals as long as they're bundled with bonds into structured notes, and the financial sector reforms enacted since the crisis have not addressed the issue. The Securities and Exchange Commission's enforcement division started a group this year to investigate structured products, including those marketed to individual investors. "We're concerned about the sale of complex structured notes to retail customers because people don't always understand the risks they're exposed to," says Kenneth R. Lench, head of the SEC's Structured and New Products unit.

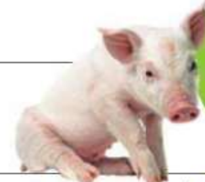
With interest rates near 0 percent, investors are ignoring potential risks and snapping up bonds that promise higher yields, even if they carry obscure names such as Leveraged CMS Curve and S&P 500 Index Linked Callable notes. Reverse-convertible notes paid 13 percent interest, on average, this year, according to Bloomberg data. That's more than 10 times the average 1.2 percent rate on one-year certificates of deposit and more than three times the average U.S. investment-grade bond yield of 3.73 percent.

Sales of structured notes rose to $31.9 billion through August, up 58 percent over the same period last year, according to data compiled by Bloomberg and StructuredRetailProducts.com. "People develop a product which makes a modicum of sense, then they extend it to the point of ludicrousness," says Satyajit Das, a former Citigroup derivatives banker. Das, the author of *Traders, Guns & Money*, says investors are often "seduced" into purchases without understanding the risks.

The notes are targeted at individual investors to boost banks' profit margins, Das says. **Morgan Stanley**, for example, charged a 3.5 percent fee on the Leveraged CMS Curve notes that it sold on Aug. 20, according to a prospectus. Underwriting commissions for U.S. investment-grade bonds this year average 0.5 percent, Bloomberg data show.

Individual investors are incapable of valuing structured notes and their underlying derivatives, says Kevin Kelly, manager of Scottsdale (Ariz.)-based hedge fund **Tontine Capital**. ➜

Markets&Finance



Coping with commodity shock page 53 ▶

Most structured notes are more complex than those Miller bought, he adds. Morgan Stanley's CMS Curve securities offer a fixed 10 percent rate for two years. The yield for the next 13 years is five times the difference between long- and short-term constant maturity swap rates, not to exceed 18 percent annually, earned when the Standard & Poor's 500-stock index doesn't dip below 875, according to a regulatory filing.

"It raises questions about suitability for the investor when you have products that are that complicated," says Daniel Bergstresser, a Harvard Business School professor. "Is that complexity a response to a legitimate desire the investor has or is it a smokescreen?" Mark Lake, a spokesman for Morgan Stanley, declined to comment.

Buyers are compensated fairly for the risk they take on and don't need to know the details of how derivatives work to evaluate the securities, says Keith Styrcula, chairman of the Structured Products Assn., a trade group. Issuers disclose potential pitfalls of the investments in documentation provided to buyers. Many of the products are less risky than stocks because sellers guarantee investors won't take losses even if the market falls, says Styrcula, a former JPMorgan Chase structured-notes banker. "There's a reason the market is booming," he says. "Investors are having successful experiences with structured investments, and they're coming back as repeat buyers."

Miller and Wells Fargo are in arbitration, according to her San Diego lawyer, Ronald Marron. In a February 2009 letter, the bank's legal department told Miller that the broker "explained very thoroughly his recommendation." The letter, which was provided by Marron, also said that "Mr. Baldacci recalled that you were familiar with Merck & Co. as they manufacture one of your medications." —*Zeke Faux*

The bottom line *Wall Street is selling complex securities to yield-hungry investors who may have no idea how they work—or how risky they are.*

Investing

China IPOs Are Hot in the U.S.

Mainland Chinese companies account for 5 of the 10 best-performing initial public offerings in the U.S. this year. The No. 1 spot, though, belongs to India: MakeMyTrip, the country's largest online travel company. —*Lee Spears*

Rank	Company and Location	Description	IPO date	Gain since IPO
1	MakeMyTrip *India*	Provides online travel bookings	8/11/10	+188%
2	JinkoSolar Holding *China*	Manufacturer of solar cells and silicon wafers	5/13/10	+175%
3	Qlik Technologies *U.S.*	Maker of software for businesses	7/15/10	+153%
4	hiSoft Technology International *China*	Helps companies outsource software development	6/29/10	+146%
5	Molycorp *U.S.*	Owner of the world's largest non-Chinese deposit of rare-earth metals	7/29/10	+108%
6	China Lodging Group *China*	Operates a hotel chain in China	3/25/10	+82%
7	RealPage *U.S.*	Provider of real estate management software	8/11/10	+67%
8	SouFun Holdings *China*	Operator of China's biggest property website	9/16/10	+58%
9	Camelot Information Systems *China*	Installs and maintains business-management software	7/20/10	+58%
10	Fabrinet *Cayman Islands*	Manufacturer of optical telecommunications equipment	6/24/10	+57%

DATA: BLOOMBERG, AS OF SEPT. 27

Real Estate

Faulty Foreclosures May Prolong the Slump

▶ Questions about whether lenders followed the rules may halt seizures

▶ Without proper pricing, "housing problems will persist"

Howard Cohen hasn't paid the loan on his Tukwila (Wash.) home in a year, and when he heard in mid-September that **Ally Financial**'s GMAC Mortgage unit was suspending foreclosure evictions in 23 states, it gave him hope. "Maybe I'll stay in my house, too," says Cohen, a 57-year-old commercial-loan broker whose business fell off after the financial crisis. Cohen was encouraged even though his mortgage servicer, **Bank of America**, hasn't reported any irregularities.

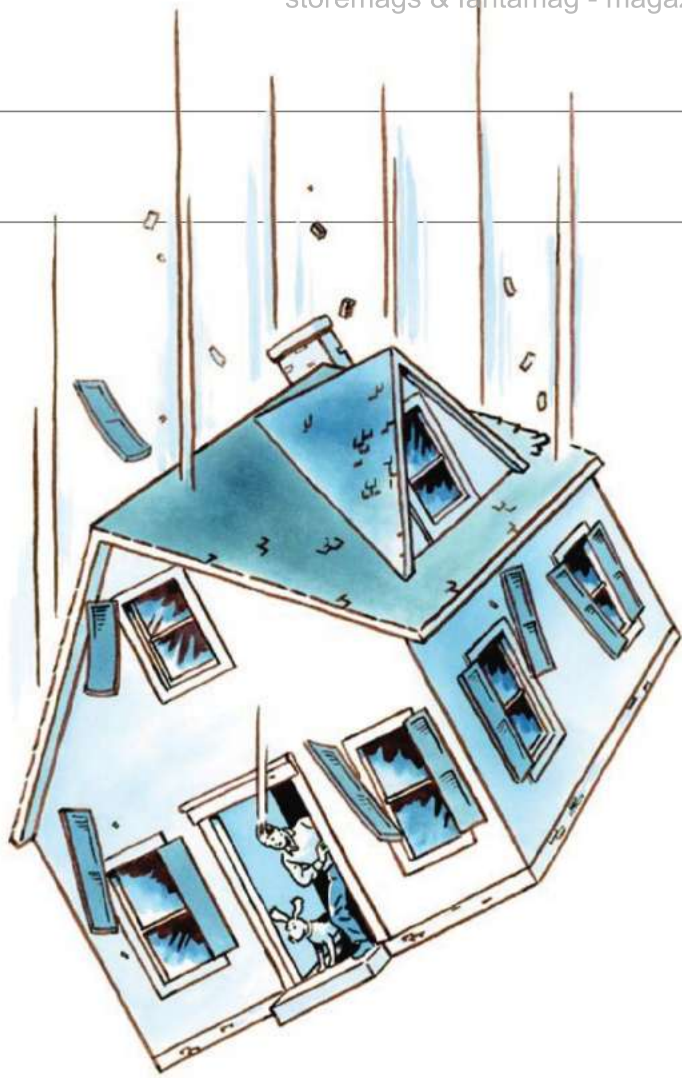
Attorneys general in Iowa, Illinois, and Texas started investigating Ally's GMAC unit after it disclosed that one of its employees said in a December 2009 deposition that he had signed thousands of foreclosure documents without verifying their accuracy. The company also faces inquiries from officials in Ohio, Colorado, and North Carolina. A **JPMorgan Chase** executive has said she signed thousands of documents without checking loan records, according to a deposition she made in a court case in Palm Beach, Fla., in May. JPMorgan spokesman Thomas Kelly declined to comment. On Sept. 29 the bank asked judges to postpone rulings in pending foreclosure cases while it reviews and possibly resubmits statements.

"Regrettably, a procedural error was found to have occurred in certain affidavits required in certain states," GMAC said in a Sept. 24 statement, adding that the problem "is not related to the accuracy of the underlying transaction." The "error" was the employee's failure to sign the documents in the presence of a notary public or signing them without "direct personal knowledge of all the information," GMAC said. The U.S. government, which has been pressing lenders to reduce foreclosures as evictions hit record levels, owns 56 percent of Detroit-based Ally. The company, formerly known as GMAC, has benefited from more than $17 billion in bailouts.

CLOCKWISE FROM TOP: OCEAN/CORBIS; ILLUSTRATION BY ROSS MACDONALD; RICK RYCROFT/AP PHOTO

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No one can say how widespread the problems are. "The suspicion is that there might have been shortcuts taken by every mortgage servicer who had extraordinary numbers of foreclosure documents to go through," says Rick Sharga, senior vice-president at RealtyTrac, a housing data provider in Irvine, Calif. In August, lenders took possession of a record 95,364 homes and issued foreclosure notices to 338,836 homeowners, according to RealtyTrac.

If uncovering deficiencies halts thousands of pending foreclosures or voids ones that have already taken place, the courts could be tied up with cases for years, says Stuart Saft, a partner at New York-based Dewey & LeBoeuf. That could further postpone a recovery. "You can't get the economy moving until this whole situation gets straightened out," Saft says. "Dragging out foreclosures doesn't help."

The foreclosure foul-ups highlight the "shadow inventory" problem—the vast number of homes now in default or foreclosure that may flood the market, further depressing prices. "Buyers know [prices haven't] hit bottom," says Joshua Shapiro, chief U.S. economist at Maria Fiorini Ramirez, a New York forecasting firm. "So they're sitting on the sidelines."

In the 23 states where judges must approve foreclosures, the average time between borrowers falling behind and sales of their properties has climbed to almost 25 months from fewer than 18 at the start of 2007, according to data compiled by Austin (Tex.)-based Amherst Securities. The increasing time between default and foreclosure may encourage more homeowners to stop paying, says Cameron Findlay, chief economist at LendingTree.com in Irvine, Calif. Overwhelmed lenders are likely to address the worst cases first, leaving many delinquent borrowers in their homes for longer periods, he says.

Other paperwork problems could also keep homeowners in limbo. Cohen, who is 12 months behind on his mortgage payments, says he's been trying to negotiate a loan modification. He anticipates difficulties down the road, he says, because "nobody can tell me who owns my mortgage." —*Bob Ivry, Prashant Gopal, and Jody Shenn*

The bottom line *Problems with the paperwork surrounding foreclosures threaten to delay the housing recovery and prolong the economic slump.*

Investment Banking

Macquarie's Makeover Fails to Dazzle Investors

▶ The bank's new focus on mergers and underwriting hasn't clicked yet

▶ "Investors expect more than they are seeing at the moment"

A few years ago, **Macquarie Group** was one of the best-performing players in global finance. Helped by its infrastructure unit, Australia's biggest investment bank strung together 16 years of continuous profit growth by buying and then running everything from wind farms in France to the elevated, six-lane Chicago Skyway toll road. Then came the financial crisis that began in 2007 and cut off the flow of cheap credit that had financed Macquarie's investment strategy.

Macquarie Chief Executive Officer Nicholas Moore has tried to reposition the bank by spending at least $778 million on acquisitions of smaller banks in North America in 2009. The bank has pulled back from infrastructure investing and is focusing on merger advice, energy trading, and equity underwriting. So far the strategy hasn't paid off, given the slowdown in global mergers and share sales in the wake of the credit crisis and a tough climate for investment banks seeking fees generally. Moore, who declined to be interviewed, has said the new strategy will take years to yield results.

That became clear when Moore recently disclosed that the bank's profit in the six months ending Sept. 30 is set to slump 25 percent, to about $359 million Australian ($452 million), the lowest for that period since 2004. "They're in a bit of a quandary," says Wes Nason, an analyst at Citigroup in Melbourne. "Investors expect more than they're seeing at the moment."

Macquarie has been aggressive about snapping



Moore's bank may be subject to boom-and-bust cycles after all

up assets in the wake of the financial crisis. Among them: London-based investment bank **Fox-Pitt Kelton Cochran Caronia Waller**, Philadelphia-based asset manager **Delaware Investments**, Calgary-based energy advisory **Tristone Capital Global**, and **Constellation Energy Group**'s Houston-based natural gas trading unit.

While Macquarie was able to pick up assets at attractive prices, the bank still faces challenges, says Lee Mickelburough, who helps manage $3.5 billion at Perennial Investment Partners in Melbourne. When Moore started buying companies, "It was the bottom of the market and all his competitors were basically bankrupt," says Mickelburough. "But they [rival banks] have come back to life within 12 months, and they're bigger and uglier than before."

In Australia, which accounts for almost half of Macquarie's income, U.S. rivals are providing stiffer competition as Moore uncouples the bank from the infrastructure-focused model he helped pioneer during more than two decades at the company. That strategy involved buying assets such as the 407 ETR highway near Toronto and the Indiana Toll Road, listing them on an exchange, and charging fees for managing them. "The model provided the investment deals, which kept the investment bank business fully occupied," says Mickelburough.

The bank is losing ground on several fronts. Macquarie ranks 13th this year in Australia when it comes to advising on mergers, a market now dominated by **Goldman Sachs** and **Bank of America**, according to data compiled by Bloomberg. In North America, Macquarie has slipped to 38th among takeover arrangers in 2010 from 23rd last year. Shares have slumped more than a third from last year's peak in Sydney trading. With profits set to fall, pressure is mounting for Macquarie to cut its 14,600-strong workforce. "They're starting to look like a normal investment bank where you're subject to boom-and-bust cycles like everybody else," says Citigroup's Nason. "And in the bust, you've got to cut people to try and maintain a bottom line."

—*Angus Whitley*

The bottom line *Macquarie's shift away from infrastructure deals and to advisory work hasn't generated the rebound investors had hoped for.*



Mutual Funds

Indexing Helps Vanguard Top Fidelity

▶ It passes the home of Magellan as investors lose faith in managers

▶ "People do not want...stockpickers who have not earned their keep"

John Bogle has preached the virtues of low-cost indexing since the 1970s, arguing that it doesn't make sense for investors to pay higher fees for big-name money managers at firms such as **Fidelity Investments**. His advocacy of investors' interests earned him the nickname "Saint Jack," and his persistence paid off this year when **Vanguard Group** unseated Fidelity as the largest U.S. mutual fund company by assets, a distinction the Boston firm had held for more than two decades.

Bogle, 81, founded the Valley Forge (Pa.)-based firm in 1975 with the idea that most professionals can't beat the market, so it's not worth paying them to try. Edward "Ned" Johnson, 80, took over Fidelity two years later and built the family business by betting on star stockpickers such as Peter Lynch. Index funds mimic the benchmarks they are designed to track, while active managers pick securities based on research. In the 10 years ended Aug. 31, domestic equity index funds posted an annual loss of 2 percent, Morningstar data show, while actively run stock funds returned 0.9 percent a year. Many active managers, of course, returned less than the average.

Fidelity Magellan, run by prominent managers including Johnson, Lynch, and Jeffrey Vinik, was once the world's largest mutual fund, peaking at $110 billion in August 2000. It is now one-fourth the size of the $87 billion **Vanguard 500 Index Fund**. Vanguard has benefited as the stock market floundered, says Michael Miller, a managing director at the firm. "People pay more attention to costs when returns are less," he says. Fidelity spokesman Vincent Loporchio says his firm's "focus has never been on being the largest company, but on providing the best products and services for our customers."

"It is possible investing has changed for good," says Jack Ablin, chief investment officer at Chicago-based Harris Private Bank, which manages $55 billion. "People don't want to rely on stockpickers who have not earned their keep." Stock index funds charge an average of 29¢ per $100 invested, compared with 95¢ for active funds, data from research firm Lipper show.

FROM LEFT: STEPHEN VOSS/REDUX; SIMON AND SCHUSTER/BLOOMBERG

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Bogle, the apostle of low-cost index-fund investing

Vanguard snatched the No. 1 ranking from Fidelity in March and has maintained it. Vanguard had $1.31 trillion in fund assets as of July 31, compared with $1.24 trillion for its main rival, according to the most recent data from the Investment Company Institute, a trade group. Fidelity has topped the list at the end of each year since 1988, when the firm overtook **Merrill Lynch**.

In the 10 years ended Dec. 31, Vanguard's stock and bond funds took in $440 billion, compared with $101 billion for Fidelity, Morningstar estimates. This year through August, Vanguard drew $49 billion while Fidelity had withdrawals of $2.8 billion. Almost 80 percent of the money flowing to Vanguard's stock and bond funds this year went to indexing, according to Morningstar.

The tally includes stock, bond, and money market funds. The figures do not count exchange-traded funds, a variation of index funds whose prices change as they trade through the day like stocks. Vanguard had $113 billion in ETF assets at the end of August, according to State Street. Fidelity has largely ignored that business. Vanguard also benefited from the popularity of its bond funds, which pulled in $134 billion from Jan. 1, 2008, through Aug. 31, 2010, a period in which Fidelity's attracted $33 billion.

Bogle has long criticized the financial industry for its supposed excesses, says Nancy Koehn, a professor at Harvard Business School. "The world has changed profoundly," she says, "and Vanguard is sitting right where the market has arrived." —*Charles Stein*

The bottom line *The growing popularity of low-cost index funds, a Vanguard specialty, has helped the company overtake Fidelity, known for stockpicking.*

College Finance

Paying the Price For Following Yale

- Top schools are forced to increase borrowing to raise operating funds
- "They thought they were terribly clever, and they took those risks"

Harvard and Yale, with combined endowments of more than $44 billion, are among 15 wealthy colleges and universities that borrowed $7.2 billion between December 2008 and November 2009 because their sophisticated investing had left them strapped for cash. The unprecedented borrowing took place as the schools cut at least 2,000 jobs, froze faculty salaries, and scaled back expansion plans. The interest on the bonds they issued costs the institutions a total of about $360 million a year, according to data compiled by Bloomberg.

The expense is the price the colleges are paying for embracing the investing model pioneered by Yale's David Swensen. After he was hired to run the endowment in 1985, Swensen put money into real estate, private equity, hedge funds, and other nontraditional assets. Yale had the best-performing university endowment in the decade preceding the recession, growing at an annual average rate of 16.3 percent through June 30, 2008.

When the credit crisis hit, Yale and other schools that had loaded up on hard-to-sell assets found themselves short on cash to run their campuses and to meet investment commitments to private equity funds. "They thought they were terribly clever, and they took those risks and now they are paying for them," says Andrew Hacker, professor emeritus of political science at the City University of New York's Queens College.

The 15 colleges have never sold so much in taxable long-term bonds before, according to John Nelson, head of the higher education group at Moody's Investors Service. The borrowing left the schools with 25 percent more debt on their books, Moody's reports show; most of the bonds mature in 2019. Overall, indebtedness of the 287 private, nonprofit universities tracked by Moody's rose to a record $75.4 billion in 2009, almost doubling in five years, Nelson says.

The bonds were taxable, rather than tax-exempt, which carry lower interest rates. That's because much of the proceeds were used to pay for operations and bolster reserves rather than fund capital improvements, according to bond documents, rating reports, and interviews with school officials.

Harvard, with $36.6 billion in its endowment at the end of fiscal 2008—more than any other institution of higher education in the world—was forced to sell $1.5 billion of taxable bonds in December 2008, three months after Lehman Brothers went bankrupt, and is paying $87.5 million a year in interest, according to data compiled by Bloomberg. Among the 15 schools, Harvard borrowed at the highest rate, selling 30-year bonds that paid a coupon of 6.5 percent, 3.37 percentage points more than the rate for comparable Treasuries.

To help close budget gaps, the university removed hot breakfasts from weekday dormitory menus, reduced shuttle bus service between campuses, offered retirement incentives to staff, and cut capital spending by 50 percent, including shelving an expansion in neighboring Allston. John Longbrake, a Harvard spokesman, declined to comment. For the year ended June 30, 2009, Harvard's endowment lost 27.3 percent; it earned 11 percent in the following year, and totaled $27.4 billion after accounting for donations and distributions.



Swensen's model worked beautifully until the credit crisis hit

Yale, which saw its investments lose 24.6 percent

50

Michael Lewis

The Mystery of the Disappearing Prop Traders



In the runup to the vote on the financial reform bill, the big Wall Street banks squashed an attempt by Senator Carl Levin (D-Mich.) to pass a simple ban on any form of proprietary trading. The final version of the financial reform bill restricts proprietary trading but allows big Wall Street firms to invest up to 3 percent of their capital in their own internal hedge funds. How exactly the new rules are enforced is left to regulators inside the Federal Reserve, but it's not hard to see how a wholly owned hedge fund might become a proprietary trading group, with a different name. The 3 percent loophole amounted to an invitation for the big banks to keep on doing at least some of what they had been doing—which is why Levin felt compelled to remove it, and the banks fought so hard to keep it.

Yet in the past few weeks news has leaked that Morgan Stanley, JPMorgan Chase, and Goldman Sachs all intend either to close their proprietary trading units or to sell their interests in the hedge funds they control. Something is wrong with this picture. Why fight for a right, and win, only to proceed as if you have lost? Why take prisoners only to surrender to them? Having preserved their loophole, the big American banks now appear to be freely abandoning any attempt to exploit it. (Credit Suisse, meanwhile, just bought a stake in a hedge fund.)

To see Wall Street turn its back on money is as unsettling as watching a shark's fin veer away, and then sink from view. It leaves you wanting to know where the shark has gone, and why. None of the firms have offered a good explanation for their new and seemingly improved behavior, but it's not hard to think up several. From least plausible to most:

1) Having not merely preserved but bolstered their place at the heart of capitalism—with little banks failing everywhere, the big keep getting bigger and stronger—the major Wall Street firms have experienced an epiphany about their relationship to the wider society. They don't need to screw people! In a smaller and less competitive financial industry, it will pay to be the nice guy, and so Goldman Sachs now wants to play nice.

2) The big Wall Street firms have looked anew at proprietary trading and have seen a dying business. For a start, their proprietary traders, put off by subpoenas and government inquiries and the new internal aversion to short-term pain on big trading positions, are fleeing for the privacy of hedge funds. But the exodus of trading talent is only part of the problem. A general malaise has come over the world of big-time financial risk taking. Everywhere you look, hedge funds are either closing or shedding employees or, most shockingly, cutting their fees. At the bottom of this new trend lies a deeper problem: a scarcity of suckers.

The proprietary trading business turns in part on one's ability to find the fool—to find people willing to take the stupid side of the smart bets you are placing. One of the side effects of our seemingly endless financial crisis is to wash a lot of fools, many of them German, out of the game. It's as if a casino owner awakened one morning to find the tourists had all gone, and the only remaining patrons were pros counting cards.

Prop trading isn't what it used to be. At the same time it's a far greater nuisance than it ever was. It's not worth the trouble to prop trade, unless you can prop trade in some wholly novel way. Which brings us to a third explanation:

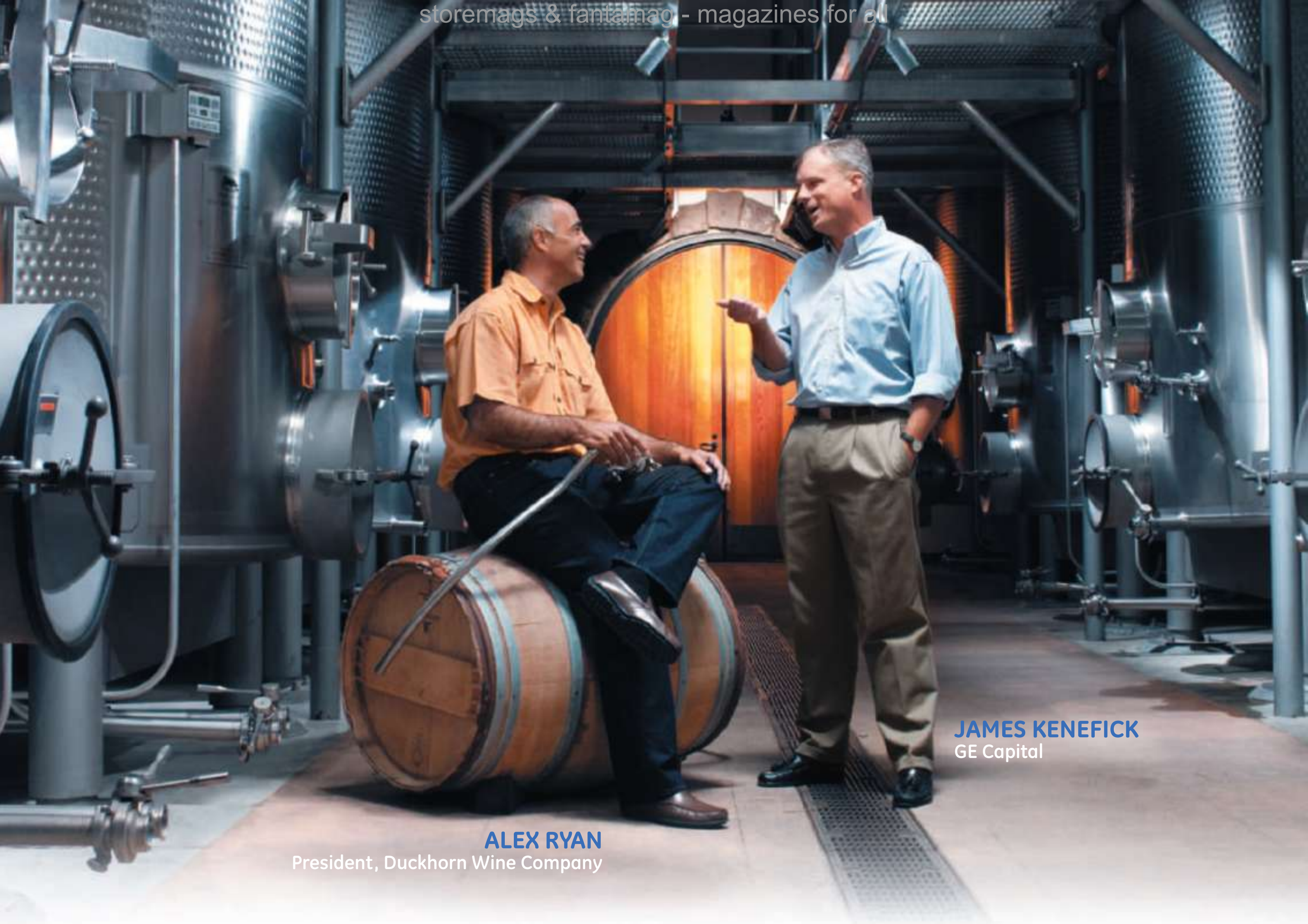
3) Goldman Sachs and Morgan Stanley and JPMorgan Chase are not abandoning proprietary trading. They are just giving it a different name, for appearance's sake. They are dismantling the units called "proprietary trading" and shifting the activity onto trading desks that deal directly with customers. (Which would explain why so few "prop traders" are being let go.) After all, you don't need a proprietary trading desk to engage in the two activities that any proprietary trading ban would seek to prevent: 1) running huge trading risks; and 2) taking the other side of the customers' stupid trades. Goldman Sachs' infamous Abacus program—the one that talked AIG into selling vast amounts of cheap insurance to offset subprime mortgage risk, and then shorted the instruments they themselves had created—was not dreamed up by the prop trading desk. It was the brainchild of what customers knew as the "Client Facing Group."

In short, there are any number of explanations why Wall Street firms are all at once letting it be known they intend simply to walk away from what has been, until very recently, their single most lucrative line of work. The answer could be none of the above or some mixture of the three. But what's really striking is how little ability the outside world retains to find out what is going on inside these places—even after we have learned that what we don't know about them can kill us. Yet news of the death of the Wall Street prop trader has been greeted with hardly a peep. And I wonder: Is this the nature of our financial world going forward? Big decisions, in which the public has a clear interest, being made outside public view, with little public discussion or understanding. If so, it isn't a future at all. It's just the past, repeating itself. B

ILLUSTRATION BY TIMOTHY GOODMAN

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GE Capital is invested in Duckhorn Wine Company.

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in fiscal 2009, sold $1 billion of five-year bonds in November 2009 at an annual rate of 2.9 percent; the interest cost to Yale is $29 million a year. The university cut $350 million from its annual budget by postponing $2 billion in construction, eliminating at least 600 jobs, and reducing the number of new graduate students. Tom Conroy, a spokesman for Yale, and Swensen declined to comment. Yale's endowment earned 8.9 percent in the year ended June 30, when it was valued at $16.7 billion after contributions and expenditures.

Stanford University, the third-wealthiest university in the U.S., borrowed $1 billion in April 2009 as its endowment dropped 27 percent. It's paying $42 million a year in interest for the money. Stanford, whose endowment stands at $13.8 billion, had an investment gain of 14.4 percent in the year ending June 30.

Universities with the biggest endowments faced the most severe cash crises because they were the most dependent on investment earnings to finance their operating budgets, says William Jarvis, head of research at the Commonfund Institute, a division of Wilton (Conn.) money manager Commonfund. Borrowing to raise cash was cheaper than selling assets tumbling in value and easier than making even deeper spending cuts, he says. The $1.44 billion Harvard spent from its endowment to subsidize operations last year represented 37.6 percent of its total budget. At Yale, the figure was about 45 percent, according to its website.

Colleges were so confident of ever-increasing returns that they directed their cash on hand into the endowments to make more money, further fueling the crisis as returns plummeted. Harvard lost $1.8 billion of the $6.5 billion in its general operating account in the year ended on June 30, 2009, because most of the cash was invested in the endowment. "Normally when you have a calamitous event, the worst impacts are on the weakest organizations," says Nelson of Moody's. "In this case, you had the strongest universities have the most severe impacts because they were dependent on investment income for a higher share of their operating budgets." **B** —*Michael McDonald*

The bottom line *Sophisticated investing strategies paid off during the boom but created an expensive cash squeeze when the financial markets froze.*

Bid & Ask

by Cristina Lindblad



1 **Petroleo Brasileiro** raised as much as $70 billion in the world's largest share sale. Brazil's state-controlled oil company will use the cash to fund development of offshore deposits.

2 **Wal-Mart Stores** has offered $4.6 billion for Massmart Holdings, a South African retailer with 290 stores. If it goes through, the acquisition would be Wal-Mart's largest in more than a decade and the first by a global retailer in South Africa.

3 **Unilever** is paying $3.7 billion in cash for Alberto Culver. The deal will add V05, Nexxus, and TRESemmé to the Anglo-Dutch company's portfolio of hair-care brands.

4 **Ardagh Glass**, an Irish packaging manufacturer, is buying Impress Cooperative, a Dutch company that is a leading supplier of food cans, for $2.3 billion.

5 **Southwest Airlines** is purchasing AirTran for about $1.4 billion. The low-fare carrier will gain a foothold in Atlanta, which has the world's busiest airport, and add flights to Mexico and the Caribbean.

6 **Endo Pharmaceuticals**, a Pennsylvania-based maker of branded pain medications, is paying $1.2 billion for Qualitest Pharmaceuticals in a deal that will give it an entry into the $13.5 billion U.S. market for generic drugs.

7 **Germany** will close the books on World War I with a final $94 million reparation payment that will go to individuals, pension funds, and corporations holding bonds issued in 1924 and 1930.

8 **AOL** is paying about $25 million for the TechCrunch news blog, say sources who declined to be identified. The company also acquired online video network 5min Media and Thing Labs, a creator of social networking tools, for undisclosed terms.

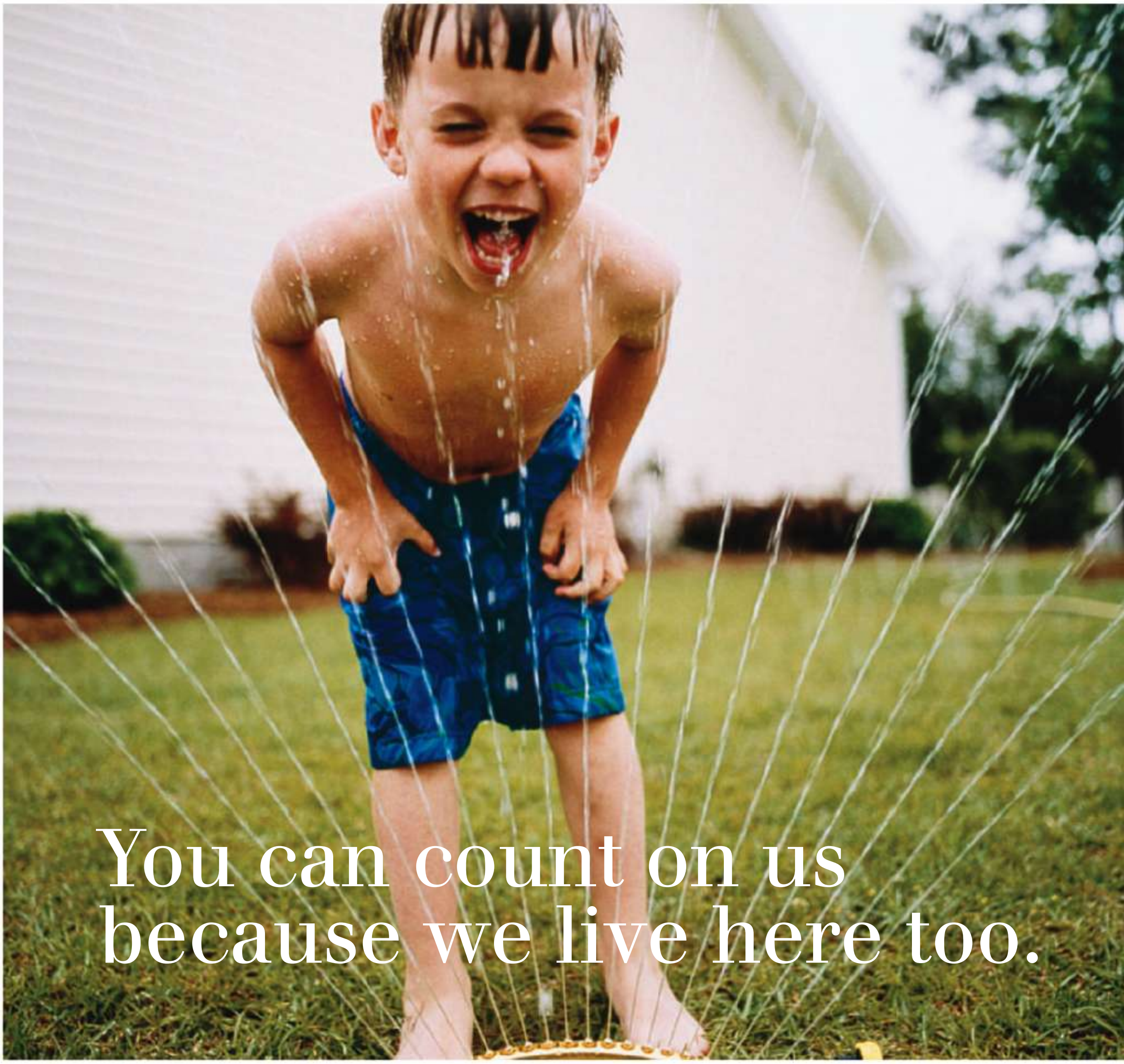
9 Oliver Stone's ***Wall Street: Money Never Sleeps*** took in $19 million on its opening weekend—enough to earn it the No. 1 box-office spot but short of the $23 million analysts predicted.

10 A pair of signs from the European headquarters of bankrupt investment bank **Lehman Brothers** fetched $111,700 at a Christie's auction in London.

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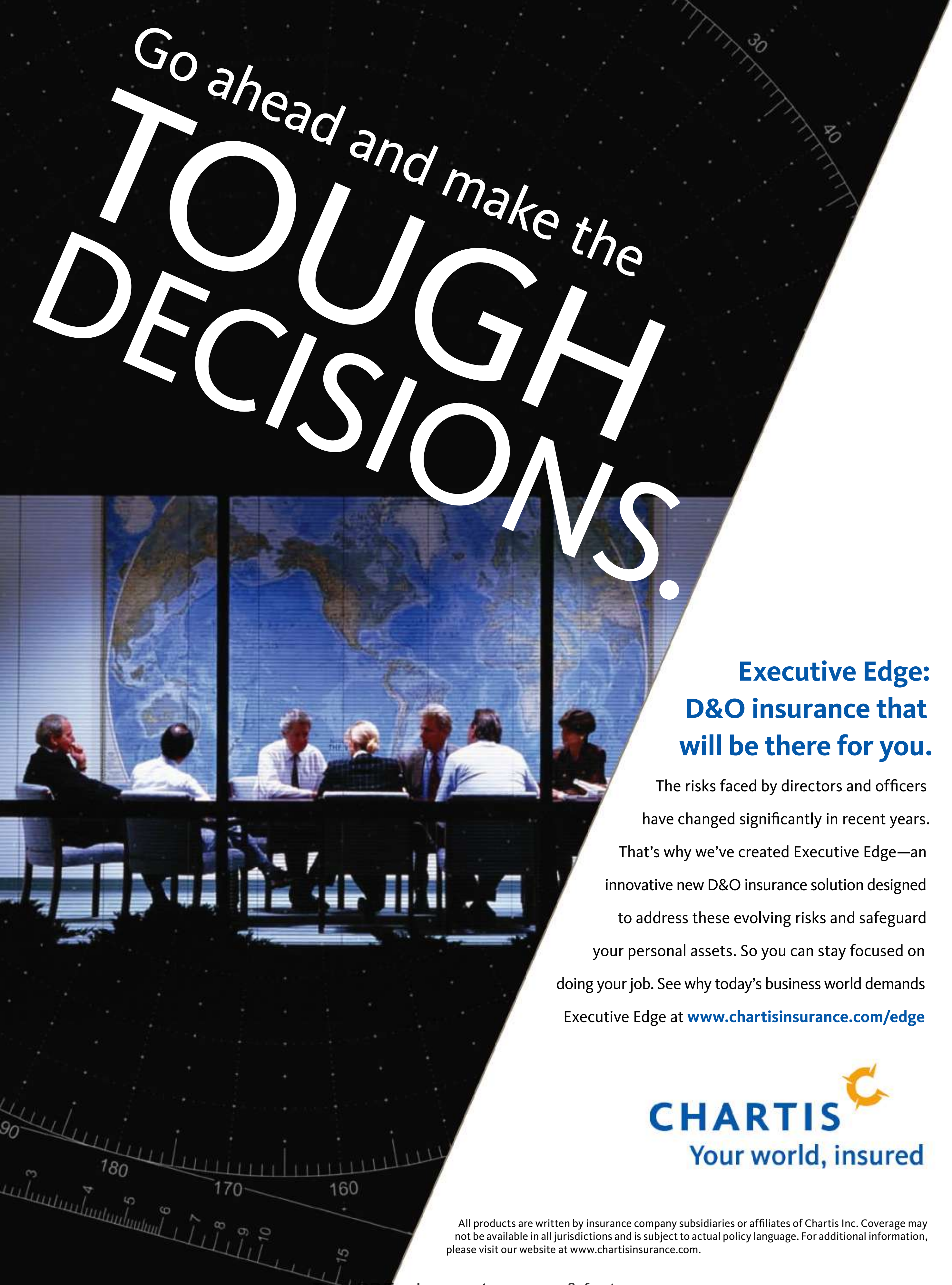
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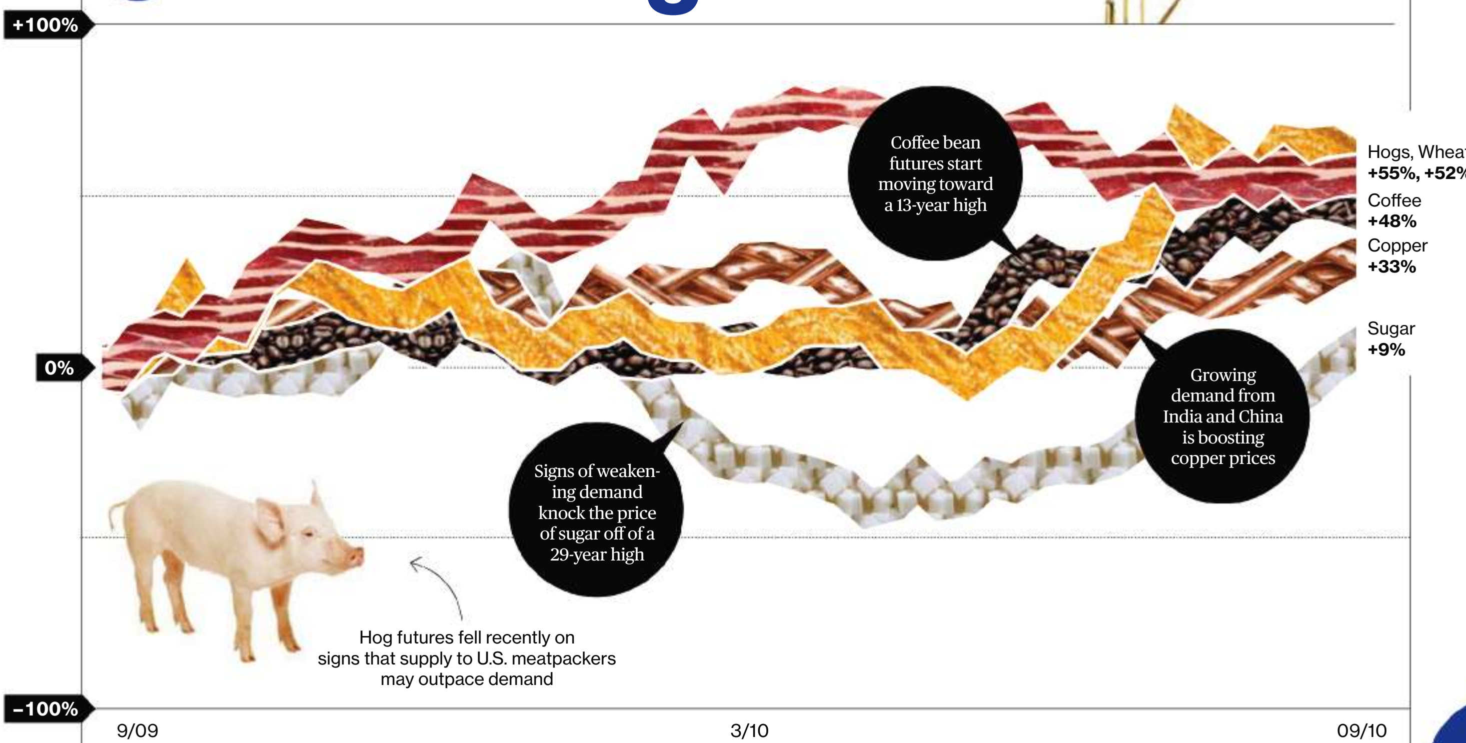
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▶ Commentary: Matthew Lynn on rethinking investor risk 56 ● Edited by Suzanne Woolley and Barry Maggs



Coping With Commodity Shock

▶ Extreme price volatility and supply concerns are forcing companies to rethink strategies

▶ "This commodity cycle has a much bigger exogenous shock to it" than past ones

It's one expensive breakfast menu: Wheat futures up 70 percent since June. Corn at a 24-month peak. Coffee at a 13-year high. And lunch? Forget about burgers. Futures on cattle are at a 24-month high. Tofu and edamame? Soybeans are at their highest level since June 2009.

Extreme price volatility in commodities of all kinds is forcing companies to rethink their strategies—not just for managing the risk to earnings, but for making sure they can get the raw materials they need to meet growing global demand for their products. Moves range from Chinese car and battery maker **BYD**'s recent purchase of 18 percent of a Chinese lithium mine to **Mars'** recent work with **IBM** and the U.S. Agriculture Dept. to sequence the cacao genome and, it hopes, breed a hardier cocoa tree.

Commodity price spikes are nothing new, and companies have long hedged against them. "The difference is that this cycle has a much bigger exogenous shock to it," says Harold L. Sirkin, a senior partner at Boston Consulting Group. "About one billion people from the developing countries will move from poverty into the world of consumerism over the next decade." Concern about tighter supply and more extreme weather has companies "absolutely more focused" on managing commodity exposure, says Sirkin.

Most companies hedge with financial derivatives such as futures contracts. **General Mills**' earnings gain in the latest quarter was due in part to a jump in the value of hedges on grain it entered into when prices were lower. Such contracts roll over periodically, so companies face the risk of having to lock in higher prices. General Mills says it has locked in about 65 percent of its need for commodities and energy for fiscal 2011.

Buying into a supply chain, as BYD did, is the most extreme response to uncertainty. **ArcelorMittal**, the world's largest steelmaker, purchases iron ore and coal mines so it has the materials it needs to make steel. On Sept. 16, ArcelorMittal said it would spend about $4 billion to expand iron ore production to 100 million tons by 2015. When you secure raw materials that way, "you're making a very big bet," says Hans-Kristian Bryn, a partner in the London office of consulting firm Oliver Wyman. "You're saying: How much capital am I willing to tie up to make sure I've got a bigger degree of control over my physical security?"

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Risk Management

The German miracle
page 67 ▶



Some companies take a hands-on approach to ensuring supply. On Aug. 27, **Nestlé** launched a program to invest 500 million Swiss francs ($508.6 million) in coffee projects by 2020. Nestlé agronomists will provide advice to farmers and give them 220 million high-yield, disease-resistant coffee plants. Last October the company said it would spend 110 million Swiss francs to improve the quality of cocoa, pledging to give farmers 12 million cocoa plants by 2020. Japan's **Bridgestone Group** just announced a similar, smaller project for growers of rubber trees.

Companies can hike prices, which could alienate customers or cause them to opt for lower-margin private label goods. At **Starbucks**, recent increases in the cost of buying beans and other necessities such as dairy, sugar, and cocoa led to a change in pricing strategy. On Aug. 17, Starbucks stated on its website that it intended to absorb rising bean prices. Then, on Sept. 22, it said it would raise prices on "labor-intensive and larger-sized beverages" in some markets. In a statement, Chief Executive Officer Howard Schultz said rising costs for key ingredients have "completely altered the economic and financial picture of many players in the coffee industry."

The likelihood of "permanent volatility" is leading to contracts that build in more flexibility, says Greg Cudahy, global managing director of Accenture's Operational Strategy Practice. For example, a company may commit to buy a set amount of a commodity, but once it hits that amount it can cut back or ramp up as needed. The supplier gets some guarantee of demand; the buyer gets more flexibility. "You can't just squeeze a supplier anymore or count on a commodity going up or down," says Cudahy. "You have to help partners lower their cost of business."

Some buyers are also lengthening contracts. An executive at a major consulting firm sees some clients going from contracts of 12 to 24 months out to five years. More contracts have price escalator or deflator clauses, based on whether a company expects inflation or deflation. So if a company that's a big consumer of wheat is making a deal with a supplier, it could lock in a price that's either fixed or is linked to all or part of the move in an index over five years. That allows the producer to lock in profit or, now that it has a guarantee of demand, make a more informed decision about expanding its crop or mine. Both parties get more certainty. And certainty is a hot commodity. —*Suzanne Woolley*

The bottom line *Spiking raw materials prices and long-term supply worries are leading clients to rethink how they manage exposure to commodities.*

Best Practices

Canada's Next Export: Financial Prudence



▶ The country wants to be a global hub of risk management

▶ "Our banking system is the best in the world"

Canada: So nice, so boring. And that's a good thing. Throughout the financial crisis, Canada managed to avoid much of the carnage that afflicted the U.S. and Europe. The only headlines it grabbed were those touting its sound banking system and solid economy. "I used to be lucky to get a few [foreign] media requests a year," says **Royal Bank of Canada** Chief Executive Officer Gordon Nixon (above). "Now I get calls every week." RBC is part of a private-public

The Commute

Risks on the Road

When it comes to managing risk, most employees overlook a common one: the dangers encountered on the way to the office. How people get to work greatly influences their odds of making it home in one piece. Below, some statistics to consider when setting out each day. —*Barry Maggs*



Plane

The odds of dying in a plane crash are about 1 in 1 million for every hour flown. Only two types of commercial aircraft still in production have yet to crash: The Airbus A340 (2.1 million flights) and the Boeing 777 (4.76 million flights).



Train

There were four train fatalities in the U.S. in 2009, not including accidents at railroad-roadway crossings. In Mumbai, according to the *Times of London*, 17 people are killed each week on the city's rail network.



Car

Over 90 percent of road fatalities occur in low- and middle-income nations, which boast only 48 percent of the world's vehicles. Among the safest places on earth for a drive: Singapore, Japan, Britain, and all of Scandinavia.



Bike

Cyclists in the U.S. are three times as likely to be killed, per mile traveled, as riders in Germany and six times as likely as those in the Netherlands. In New York City, 97 percent of cyclists who died between 1996 and 2005 weren't wearing helmets.



Walking

On a list of the world's 21 most deadly cities for pedestrians compiled by *GOOD Magazine* (based on deaths per capita), American cities took the top 11 spots, led by Atlanta and Detroit. Paris, London, and Tokyo were 16th, 17th, and 19th, respectively.



DATA: AIRSAFE.COM, U.S. BUREAU OF TRANSPORTATION STATISTICS, WORLD HEALTH ORGANIZATION, INJURY PREVENTION, NYC TRANSPORTATION DEPT.

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effort to capitalize on Canada's reputation by making Toronto a global hub for financial risk management.

The Global Risk Institute in Financial Services (GRI), set to launch in January 2011, will fund research, train executives, analyze best practices, and bring together experts and policymakers to discuss risk. To start, the federal and provincial governments will each contribute $10 million Canadian ($9.8 million), with a consortium of private-sector banks, insurers, and institutions together pledging an initial $2.5 million Canadian annually. The goal: become the go-to place for financial risk thinking. "This is our area of strength," says Ontario Finance Minister Dwight Duncan. "Our banking system is the best in the world."

While Toronto currently ranks 12th in the Z/Yen Group's Global Financial Centres Index, which measures competitiveness, it arguably outshines bigger rivals such as New York or London when it comes to risk. "We did not see the extraordinary meltdown of the financial services sector that took place in other parts of the world," says Duncan. "Canada resisted the deregulation of financial services 10 years ago."

GRI is part of a broad push to boost Toronto's reputation as a financial services hub, but GRI spokesman Brian Smith says, "We're not out to proselytize a Canadian way of doing things." What matters, adds Janet Ecker, president of the Toronto Financial Services Alliance, is providing more timely, compelling research to the global business world.

Canada's move comes at a time when governments worldwide are overhauling regulations to reduce risk. Terry Fleming, president of the Risk and Insurance Management Society, a global industry group for risk managers, says the Toronto plan complements those efforts. "Governments recognize the need for better risk management," says Fleming. Companies and boards are putting a higher priority on improving their risk management practices, too.

Whether the institute proves a catalyst for prudent thinking in the global finance world remains to be seen. "Even if it's mostly just good for Canada," says Fleming, "that's a start." —*Diane Brady*

***The bottom line**: Canada's Global Risk Institute in Financial Services wants to capitalize on the country's reputation for prudent risk management.*

Vinay Mistry

Scouring the Globe For Emerging Risks

Vinay Mistry, a member of the Lloyd's of London Exposure Management team, talks about anticipating risks in some very unusual places

What does the exposure management team do?
We have a database that covers over 370 risks, from nanotechnology through climate change. We have a team investigating what the next type of big threat could be—the next asbestosis—that could hit the insurance industry. We help underwriters be smarter about pricing risk and provide information that can help them tighten the wording of contracts, so if there is a potential risk it is being mitigated or accounted for.

Part of the team designs and implements a Realistic Disaster Scenarios framework—large stress-test scenarios, and what the impact could be on Lloyd's. There are 20 scenarios, including a hurricane that hits Florida and costs the industry over $120 billion, planes colliding over a heavily populated city, and an earthquake in Tokyo.

What are some emerging risk areas?
We're starting to talk to underwriters and academics about synthetic biology where you create your own organism, combining cells with different strains of DNA. There are no distinct regulations for this activity. We're looking at how it could impact business, implications for terrorism or for human error if a product is developed and rushed to market, the risk of unexpected gene transfer, the implications on different ecosystems.

Digital risks are another area. We started to see a shift from viruses that typically attack computers to different types of cybercrime. For example, if you have heavy machinery managed and maneuvered by a global positioning system that has been tampered with or hacked, there is a potential risk.

Among emerging natural risks, what are you focusing on?
There's space risk. There is a solar cycle, which is a period of about 11 years. It's the sun having a cycle in terms of how much electromagnetic radiation is emitted. We're entering a period of slightly elevated activity. The peak activity will be seen between 2011 and 2013. Electromagnetic radiation in space could impact satellites, but there are also "on earth" risks to ground stations, in terms of providing electricity for networks or grids that supply power to cities. A widespread, prolonged failure of electricity transmission grids would feel like going back in time to the 17th century.

And in climate change?
In the area of climate change and potential liability, Lloyd's is working with academia to better understand potential impacts. There are difficulties, particularly in differentiating the impact of natural variability and man-made impacts—and the differing impacts of greenhouse gases. Climatic changes don't mean there will be global warming—there will be distinct regional variations. Our research is shared with underwriters to help them be aware of issues. Ⓑ

—*By Suzanne Woolley*



Matthew Lynn

Focus On Risk

Up is Down–and Safe is Risky



The financial crisis took everything you knew about calibrating investment risk and turned it on its head. Don't expect it to flip back tomorrow

What is risky and what is safe? That has always been a crucial question for anyone working in the financial markets. Bankers provide their clients with an asset mix, tailored to suit the aging widow or the young entrepreneur.

But what if everything you know about risk was suddenly turned upside down? In the last two years, all the stuff we thought was really safe and dull turned out to be dangerous. And the things we thought were risky ended up being quite reliable.

This means investors need to reverse everything they thought they knew about risk. Assets such as property, the dollar, and developed-country bonds are only for those who don't mind losing their shirts. Small-time investors who depend on getting their money back should be buying into small companies, emerging markets, and private equity or hedge funds.

Risk's role in markets can't be overstated. Think of those know-your-client forms that banks get you to fill in. Describe yourself as risk-averse, and they offer you a mix of government bonds, maybe some blue-chip equities, and a lot of real estate in developed countries. Describe yourself as risk-friendly, and they get out the brochure on that hedge fund that specializes in high-velocity Kazakh yak-hide trading. Our ideas about risk determine how money flows around the world, and the price paid for it. The higher the risk, the greater the return you expect and vice versa. Unfortunately, the global financial crisis of 2008 took our long-held notions about investment risk and flipped them.

Property was always a haven—"safe as houses," as they (used to) say. It doesn't apply to homes as an asset class anymore. Take the British market. A PricewaterhouseCoopers report says that after adjusting for inflation, there is a 70 percent chance home prices will be lower in 2015 than they were in 2007. It could be 2020 before they get back to their peak in real terms. In most major markets, property is overpriced and dependent on bank financing that has dried up.

Government bonds, anyone? If you held Greek debt, your portfolio took a hit over the past year. If you bought U.K. or U.S. bonds, it might be looking a bit better. But you should be nervous. The markets made an example of Greece, but its budget deficit wasn't much bigger than those of the U.S. or Britain. At any moment, they might get mauled as badly as Greece did. Even if you stick with financially responsible countries such as Germany, they are still getting stuck with the bills of their neighbors in the euro area.

Likewise the dollar. The budget and trade shortfalls might create a crisis at any time. The Swiss franc? If Credit Suisse Group went bust, the whole country would be brought down. Switzerland would be the next Iceland, where foreign depositors are still fighting for their cash. So much for "money in the bank."

Our ideas about risk determine how money flows around the world, and the price paid for it

No traditionally safe asset looks solid right now. The risky stuff looks safer. Not convinced? Most emerging markets have much higher growth rates and healthier demographics than their peers in the developed world. Their currencies, bonds, and equity markets look more reliable than any in the U.S. or Europe. And corporate bonds are a better bet than most government bonds. Would you rather have your money in Vodafone Group, with millions of customers paying their phone bills every month, or in bonds issued by Britain, with its weak economy, massive welfare bill, and budget deficit equal to more than 10 percent of gross domestic product? Small companies are safer than blue chips. Just think of the problems that BP has run into in the past few months. Giant enterprises can run into giant trouble. Small ones can flourish under the radar.

Private equity and hedge funds beat bank deposits. Banks ran into trouble in the credit crunch, not the alternative-investment industry. For the foreseeable future, emerging markets are safer than developed ones, equities beat property, and corporate bonds are preferable to government notes.

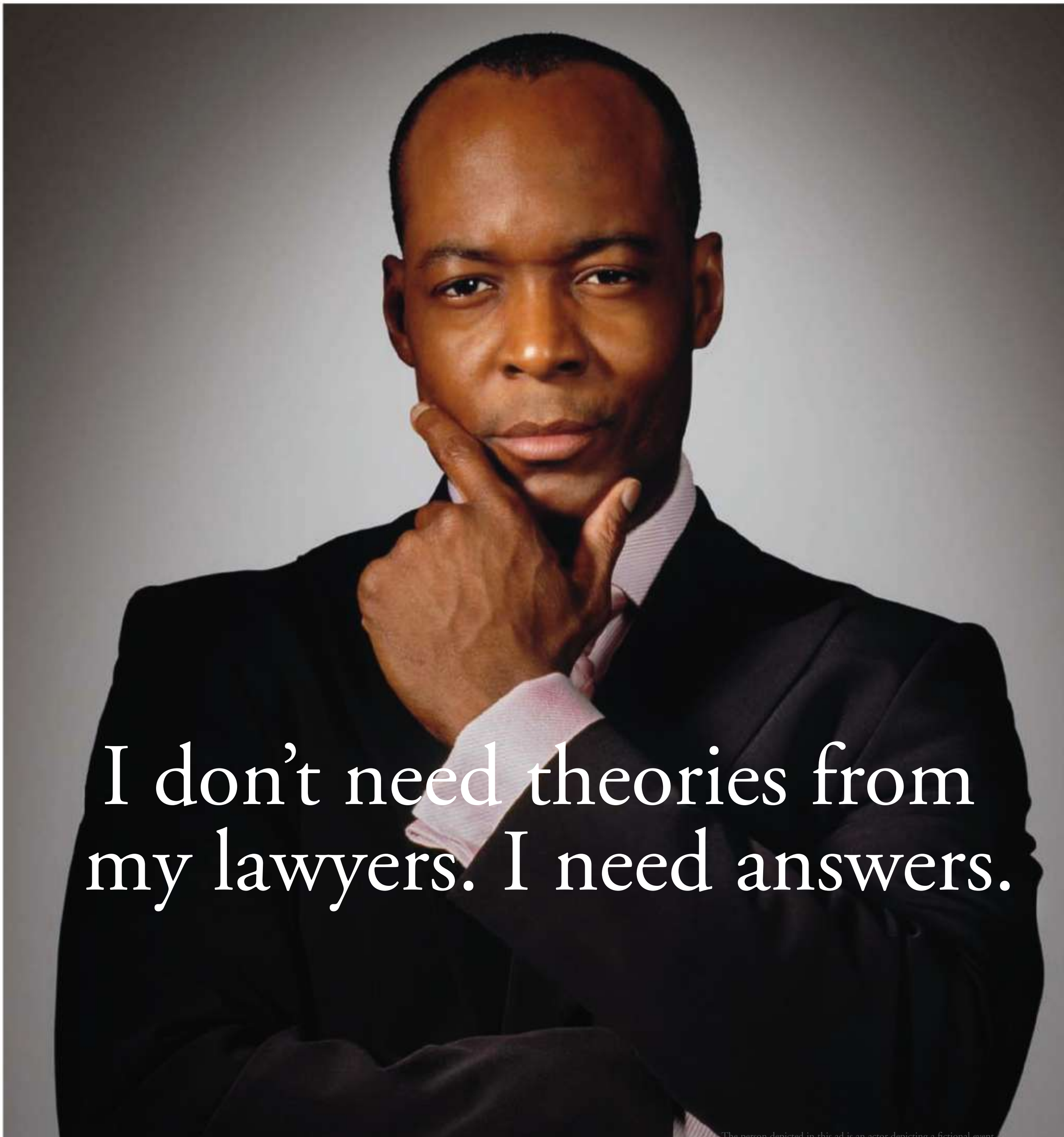
Sometime around 2015, don't be surprised if bankers are advising widows and trust funds—which need to preserve capital above all else—to get into Turkish bonds, a hedge fund or two, and a portfolio of small emerging-market stocks. Real estate, Treasury bills, and dollar or euro blue chips will be only for people who are playing with mad money—and have been warned they may lose everything. Ⓑ

Matthew Lynn is a Bloomberg News columnist and the author of the forthcoming Bust: Greece, the Euro and the Sovereign Debt Crisis.

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The Story of a Modern Economic Juggernaut



Introduction

The project of reunification seemed impossible when it started in 1990 with a $9 billion pledge to "help" the Soviets get out of East Germany. The costs only escalated from there, but the sacrifices were in service of a dream: that Germany might be united for the challenges of a globalized world. Next, Germany and its neighbors imagined a unified Europe, and the country paid for it with spending power when the strong deutsche mark was retired for a then-weaker euro. Now Germans are paying again, to prevent Greece from pulling apart the European Union. It's a fresh reminder that togetherness has its costs—though 20 years later, the benefits of reunification speak for themselves.

6%

Percent of Germans who own stocks

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How Did Two Germanys Become One?

The 20-Year Miracle



East German troops at the Brandenburg Gate, 1989

Welded together from unequal parts, modern Germany has overcome historic challenges and matured into Europe's economic powerhouse. Scenes from a marriage that's a little short on romance—and long on success.

By Romesh Ratnesar

There won't be many birthday parties for Berlin this year. The city's main thoroughfare, Unter den Linden, is still jammed with tourists, and the Prussian-era museums, destroyed by Allied bombs during World War II, have been restored to their former glory. The cafés and bars of Mitte, in what used to be East Berlin, overflow with polyglot congregations of artists and hipsters. But Berliners are staying stoic about Oct. 3, 2010—the 20th anniversary of German unification, an event that ended four decades of German division and closed the books on the Cold War. Last November the commemoration of the fall of the Berlin Wall brought 35 heads of state to the German capital. Only a handful are expected this time. Even German Chancellor Angela Merkel plans to be out of town. "We're all still exhausted from last November," says Constanze Stelzenmüller, a senior fellow at the German Marshall Fund in Berlin. "I don't find myself getting excited about Oct. 3 the way I did last year."

Most Germans identify Nov. 9, 1989—the night the Wall came down—as the date on which the nation reclaimed its destiny. The images of East Berliners running through the Wall and into the arms of strangers on the other side, of ordinary people hammering concrete and drinking champagne at the Brandenburg Gate, remain indelible. Few of the East Germans who streamed into West Berlin on that November night in 1989 would have predicted that the two Germanys could become a single, free, and democratic state within a year—or that the Iron Curtain would crumble. That the unimaginable did occur in the heart of Europe two decades ago made the world a better, safer place. And so even in the absence of conspicuous revelry, the events that culminated in the peaceful unification of Germany are still worth celebrating. When you ask Germans today to describe, 20 years later, what unification meant to them, one word invariably recurs: To them, it was a "miracle." Perhaps a bigger miracle is that the next two decades turned out as well as they did.

Today, Germany is the most important country in Europe. Its export-driven economy is the envy of the developed world. Second-quarter gross domestic product rose 9 percent, the fastest pace in two decades. German business confidence hit its highest level in more than three years in September, suggesting that German companies can withstand weaker demand for exports should the global economy slow.

The rest of Europe has become dependent on Germany's size, industry, and frugality, and many of the country's business leaders—and largest exporters—are reconciled to the need to support weaker nations. "A single European market is a blessing for all," says Wolfgang Mayrhuber, chairman and chief executive officer of Deutsche Lufthansa.

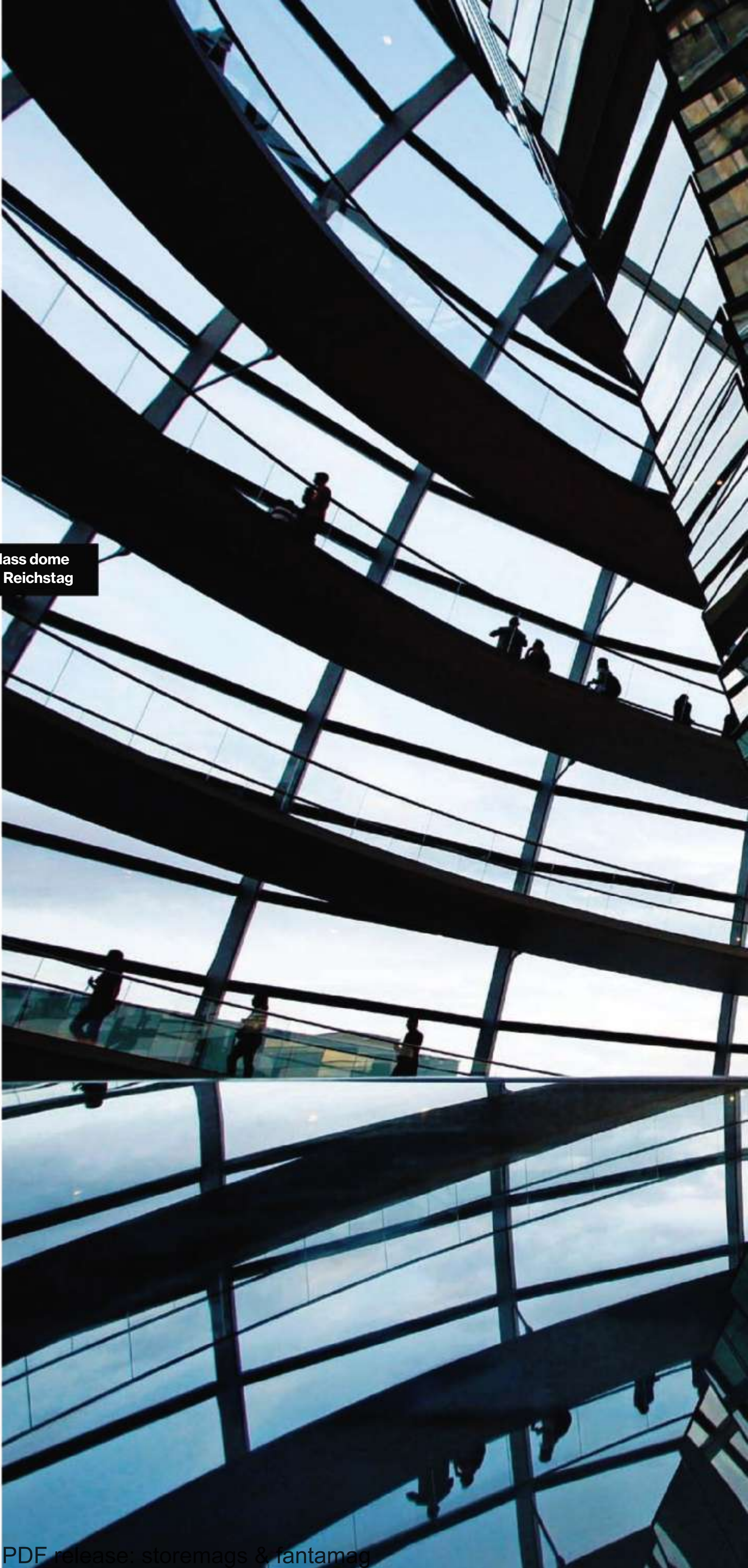
Executives may bask in Germany's status as Europe's economic engine, but ordinary Germans are still ambivalent. The Merkel government's reluctant $11 billion contribution to the EU fund that stabilized the Greek debt crisis last spring has fueled widespread euro-skepticism. According to research firm Forsa, more than half of Germans say the Greek bailout was a bad idea, and close to two-thirds believe the euro is a weak currency.

The public's reluctance to use

German strength on behalf of the rest of the Continent reflects the fact that the debate over the costs and sacrifices of unification is still fresh. West Germans have spent more than $1 trillion to rebuild the crumbling factories and cities of the East, with inconsistent results. Without tax breaks, infrastructure investment, and fast-track approvals, "most companies in the former East Germany would have stood no chance of survival," says Jürgen Hambrecht, chairman of BASF's management board. Hambrecht adds that BASF wouldn't have invested €1.3 billion in its Schwarzeide industrial site in East Germany without these incentives.

Eckhard Cordes, CEO of retailer Metro Group, says the "overall economic impact of reunification was positive." An economy of scarcity was replaced by a modern, thriving retail sector whose total space devoted to sales tripled in the six years following unification. Yet for many of the 18 million citizens of the former GDR, life in the new Germany has meant joblessness, dislocation, and the collapse of the bland security that typified life under communism. Public opinion surveys show that Germans are more willing than ever to say they are proud of their country, but soaring deficits and an aging population temper their enthusiasm. Two decades since unification, the national mood betrays as much anxiety as it does confidence. "The outside world sees a new German giant: prosperous, self-sustaining, assertive," says Ulrike Guérot, a Berlin-based senior research fellow at the European Council on Foreign Relations. "But if you look in greater detail, you see an ever more fragmented political system and society. And so there's this intuitive dissatisfaction here, a sense that something is going wrong in Germany."

Such discontent is largely unwarranted. Germany's problems pale in comparison to those faced by other industrialized nations. As Germans grapple with the implications of their growing power, it's instructive to look back on the remarkable, challenging, and sometimes painful journey that led them here. The rebirth of a united Germany was "the most moving experience in our lifetimes," in the words of former West German President Richard



The glass dome of the Reichstag

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von Weizsäcker, but it was also the start of a period during which Germans struggled to adjust—not just to each other but also to their role in Europe and their place in the world order. "It's like a marriage," says Carl von Hohenthal, a former political correspondent for the German daily *Die Welt*. "When you start out, you are very much in love, and even though you might have fears and you aren't sure about everything, you decide to do it. But eventually reality sets in."

"Screaming for Unification"

The fall of the Berlin Wall did not make unification inevitable. Although nominally self-governed, the two German states had for 40 years existed under the controlling authority of the four victorious World War II powers: the U.S., Great Britain, France, and the Soviet Union. As of 1989, hundreds of thousands of foreign troops, including close to half a million members of the Red Army, were still stationed on German soil. In the weeks leading up to Nov. 9, discontent with the Communist regime in East Germany produced huge street demonstrations and a seemingly unstoppable exodus of Germans fleeing to the West. Soviet leader Mikhail Gorbachev had told officials in the GDR that if East German citizens attempted to breach the Berlin Wall, Soviet troops would not intervene to stop them. But Gorbachev was adamant that Germany remain divided into separate states, a position shared by British Prime Minister Margaret Thatcher and French President François Mitterrand. "They were worried that history might repeat itself—that a unified Germany in the heart of Europe would lead to another conflagration," says James Baker III, Secretary of State under then-President George H. W. Bush. "We were the only ones besides the West Germans who were seriously interested in moving this thing."

The Reichstag with Berlin Wall



The West Germans had doubts of their own. Helmut Kohl, the conservative Chancellor of the Federal Republic, told aides unification would take at least five years, if it happened at all. Other West German politicians were even more skeptical. "A big part of the political class here did not believe in unification," says Michael Mertes, a former aide and speechwriter for Kohl. In the halls of the West German government at the height of the Cold War, the word "unification" was rarely, if ever, mentioned. By the 1980s, "the West had pretty much forgotten about the East," says von Hohenthal. "No one really spoke about East Germany anymore. Most young people didn't even know where some cities in the East were."

What few West Germans appreciated, or even knew about, was the sudden clamor for change among East Germans who had glimpsed freedom when the Wall came down. They had no intention of turning back. A month after the Wall's opening, Kohl made a trip to Dresden, the bombed-out city that was still a part of the East. Throngs came out to cheer him and plead for German unity. "Kohl was not a great speaker, but he had a tremendous feeling for the people," says von Hohenthal, who covered Kohl's trip for *Frankfurter Allgemeine Zeitung*, Germany's largest newspaper. "I remember looking at the faces of the people—they all were wearing black, red, and gold and chanting, 'Helmut, Helmut!' You could just sense that the East Germans were absolutely longing—screaming—for unification."

By the start of 1990 the Kohl government seized the opportunity and pushed for a rapid, one-state solution. The Soviets presented the biggest dilemma: Letting go of the GDR, Moscow's most important satellite in Central Europe, would be tantamount to conceding defeat in the Cold War. To exact agreement from the Soviets, Kohl turned to Bush, who persuaded Gorbachev to accede to unification and to accept the incorporation of a unified Germany into NATO rather than keep it neutral. In exchange, Kohl pledged $9 billion in economic aid to the Soviet Union, much of which would pay for the withdrawal and relocation of Soviet troops returning from East Germany. At a meeting in the White House Cabinet Room on June 2, 1990, Gorbachev told Bush that if a unified Germany chose to join NATO, Moscow would not stand in its way. "I don't think we ever knew for sure this would be a success," Baker says now. "But when Gorbachev agreed that a country could choose the alliance it belonged to, that's when we figured that this thing is definitely going to make it."

While Bush, Kohl, and Gorbachev hammered out a deal on NATO, the legal de-

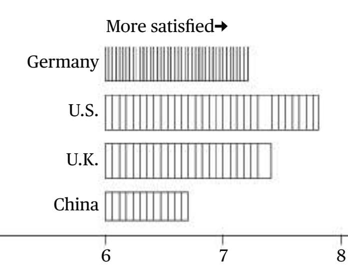
PREVIOUS SPREAD: MICHELE TANTUSSI/BLOOMBERG; THIS SPREAD: GERARD MALIE/AFP/GETTY IMAGES (2)

Golden Children

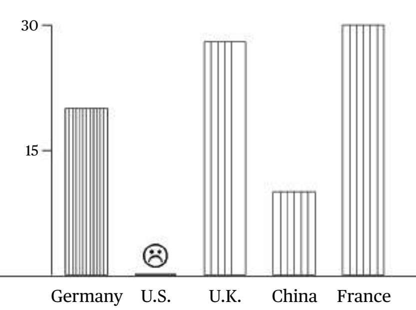
Amount parents get each month from the German government to help with the costs of raising children, per child:

€184

Life Satisfaction Index



Mandatory Vacation Days



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tails of how to unite the two states formally and remove foreign troops were worked out through the "2+4" negotiations—involving representatives of the two Germanys, plus those from the four occupying powers—a process devised by Washington to limit the circle of actors with a say over Germany's future. The final treaty reestablishing German sovereignty was drafted by the end of the summer and signed in Moscow on Sept. 12, 1990, astonishingly quick by the glacial standards of international diplomacy.

The negotiators had glossed over the consequences for the citizens of the GDR, many of whom were unprepared for the coming transformation of their way of life. Yet it's difficult to see how it could have happened any other way. Within a year of the Moscow treaty, Gorbachev was pushed out of power by hardliners in the Kremlin. The Soviet empire collapsed. Negotiating with more mercurial figures in Moscow, let alone with the leaders of 15 newly independent former Soviet republics, might well have proved impossible for Western officials. "There was no script," says Wolfgang Ischinger, a former German ambassador to Washington, who was at the time an official in the West German Foreign Ministry. "Nowhere in the world had there been this kind of process, of unifying two neighboring countries that belonged to two diametrically opposed political systems. There was no plan that we were able to pull from our desks to show us how to do it. We had to invent solutions as we moved forward."

"Poor Cousins"

By some measures, the results have been uneven. Despite the transfer of $1 trillion from West to East since unification,

The Reichstag, post-Wall

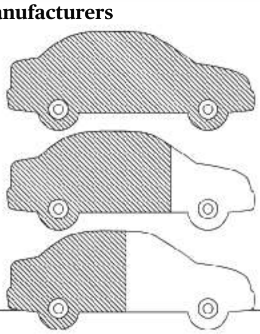


living conditions in much of the former East Germany show few signs of improvement. With the disappearance of internal borders, some 2 million East Germans moved west, sapping the region of what little intellectual capital and technical knowhow it had left. Industrial towns once heavily subsidized by the Communists collapsed. At least one of Kohl's early moves, to introduce the deutsche mark into the GDR at an exchange rate of 1 to 1, is now viewed as a devastating blow to East German producers, whose goods were suddenly unaffordable outside their borders. John Kornblum, a former U.S. Ambassador to Germany, says West German officials "didn't understand the need to rebuild the society structurally, politically, even spiritually. The beginning was bad–people in the GDR were like poor cousins who were given money and told to be quiet."

And now? German unemployment fell for the 14th straight month in August, and unemployment in the six states of former East Germany fell below the 1 million mark for the first time since 1991. Still, even those former residents of the GDR who have succeeded in the new Germany say a sense of disorientation persists. Over coffee in a courtyard café in Berlin, Sophie Reinhold, 28, recalls growing up on the eastern outskirts of the city in one of the soulless "concrete jungle" complexes built by the Communists. Her family, she says, was "always waiting for the moment when the Wall came down." After unification, Reinhold traveled overseas before settling in central Berlin to pursue a career as an artist. She finds she shares nothing with old acquaintances who stayed behind in the East. "I don't know anyone from back then, and I'm still in my hometown," she says. Her parents, too, have lost contact with their former neighbors from the East, many of whom failed to make the transition to life in a capitalist society. "Most of their friendships are broken," she says.

Germans acknowledge that it may take years, even decades, before the country's social fabric, sundered by a century of war and division, comes together again. "Politically we've become one country, but not economically," says Wolfgang Thierse, a former anticommunist dissident in the GDR. "We haven't finished the process. We're maybe two-thirds of the way there. But there's still a way to go." We were sitting in a conference room looking out on the Reichstag. Once the seat of the German empire, the building was razed by the Nazis, plundered during World War II, and rebuilt after unification. It is now home to the German Parliament, of which Thierse is vice-president. It was a bright fall afternoon, and I could see tourists making their way up and down the ramps of the Reichstag's redesigned glass

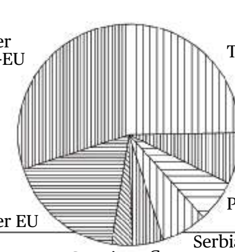
Top Car Manufacturers



The Unification Generation
Portion of population born after 1990

18%

Immigration
Nation of origin for immigrants in Germany as of December 2009



DATA: FEDERAL EMPLOYMENT AGENCY; NEF; MERCER; INTERNATIONAL ORGANIZATION OF MOTOR VEHICLE MANUFACTURERS; FEDERAL STATISTICS BUREAU

16,000

sacks of shredded Stasi files slowly being pieced back together at an archive in Berlin.

dome, a sight that serves as a reminder both of Germany's past and how far the country has traveled to overcome it. Indeed, for all the travails of unification, precious few East Germans would go back to the old days, even if they could. When asked by the research firm Sozialreport earlier this year whether they wanted the Wall back, only 9 percent of East Germans said yes—fewer than the number of West Germans (11 percent) who did.

Accelerating EU Growth

How much has Germany changed since 1990? Put the question to Germans, and many will point to the transformation of the country's self-image, the sense of national pride that was consciously suppressed, in both East and West, after the horrors of World War II. "What happened in the 20th century is still a nightmare in our souls," says von Hohenthal. "The crimes of the Nazis and the experience of losing two world wars made us deeply insecure. For a long time, we weren't sure about our culture and our position in the world. And so we shut up and made money. Nothing else was expected of us." The aversion to public displays of patriotism fell away in 2006, when Germany hosted the World Cup. The nation was awash in the colors of the German flag. "We startled ourselves," von Hohenthal says. "It was the first time we truly accepted that we were no longer disliked by the rest of the world."

The admiration Germany enjoys today has been hard-won. In the years following unification, Germany was often described as "the sick man of Europe," in part because of the enervating cost of uniting two separate disparate economies. Perceptions changed after Chancellor Gerhard Schröder, a Social Democrat, deserted many of his party's tenets in 2003 to propose cost-curbing measures on Germany's social system. Called "Agenda 2010," Schröder's plan included tax cuts and reductions in pension benefits and reimbursement for medical expenses. In return, German industrialists promised to maintain employment in tough economic times through shorter workweeks and extensive training programs, even if profits suffered. "Schröder's implementation of Agenda 2010 produced a series of surprisingly significant reforms in Germany," says Mathias Döpfner, chairman and CEO of German publisher Springer. "The concessions from labor in the last 10 years added a competitive edge to German products," says Cordes, Metro Group's CEO. "They have played a key role in Germany regaining its economic edge." BASF's Hambrecht adds that "German companies are more long-term focused" and management is more focused on stakeholders, including workers, than on shareholders. "The aftertax return on sales, for example, normally is below the average returns in the Anglo-Saxon economies because we strive for a different balance between economy, ecology, and social responsibility."

Today, says Lufthansa's Mayrhuber, "The structure of German industry is healthy. Good products, known brands, a solid mixture of small, innovative businesses networking with globally recognized corporations" generate the right balance between risks and rewards.

Germany has also benefited from the painstaking efforts taken by the country's leaders to "embed" Germany in a wider European system. The creation of the euro dates to the unification debate 20 years ago when Kohl placated Mitterrand's fears about renascent German power by pledging to join a common European currency. "One of our main goals was to make it crystal clear to everyone that Germany would become an integrated part of the European Union," says Mertes. It worked. "Compared to the resentments and fears one could have seen, today no one would say Germany is in danger of becoming a hegemonic power in Europe." If anything, the German willingness to underwrite the pan-European project has accelerated other countries' rush to join it. In 20 years the EU has grown from 6 nations to 27; NATO counts 28 member states, up from 16 in 1990. It's no exaggeration to say that the contours of the Western world as we know it were forged by German unification. As a result, the European Continent is more peaceful and unified now than at any time in modern history.

Some of that unity, however, is fraying. Over the past year, Germans have watched their Western peers, notably the U.S., stumble far more during the global recession than Germany, with its export-driven economy. Even the Merkel government's domestic opponents bristle at the criticisms levied against it by outsiders like French Finance Minister Christine Lagarde, who earlier this year called on Germany to take steps to boost domestic demand and reduce its $18 billion trade surplus, all in the name of propping up weaker euro zone economies—like France's. Germans are cold to the idea of saving other EU governments from themselves, even if that threatens the viability of the euro. Although Merkel reluctantly agreed to back the Greek bailout last spring, it's far from certain she will be as generous the next time around, particularly if Germany's current rate of 3 percent economic growth slows. "We are outgrowing Europe, that is the thing," says researcher Guérot. "We want the benefits of Europe and we want to keep the euro. We are not anti-European. But Germans are saying, 'Please leave us alone. Take away this responsibility for the whole European movie.' "

In a globalized age, however, turning inward isn't an option—least of all for a nation whose prosperity at home depends so heavily on safeguarding markets abroad. "What's right or wrong isn't even a question," Guérot adds. "The reality is that because of our sheer size and economic power, it's Germany that drives the EU." That presents challenges and opportunities. With Washington's influence in decline, promoting U.S. interests will require a strong and stable Europe—which in turn depends on the leadership of an assertive Germany, mindful of its past but unafraid of the responsibilities that come with success.

Two decades after unification, Germany is "stable, democratic, and prosperous," says John Kornblum. "It's exactly what we wanted it to be." The task now for Germany's friends—something unimaginable just a few decades ago—is to help it get even stronger. **B**

Romesh Ratnesar is a Bernard L. Schwartz Fellow at the New America Foundation. His book Tear Down This Wall: A City, A President and the Speech That Ended the Cold War *is out in paperback next month.*

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Will Angela Merkel
Lead Europe?

The Perils of Pragmatism



Merkel lacks the grassroots credibility of her predecessors

Chancellor Angela Merkel is attempting a delicate trick: Supporting the EU and the euro without sacrificing her political career

By James Neuger

For a fleeting moment last spring, it was possible to believe that Europe's economic crisis had turned Angela Merkel into a true believer in the European cause. Three days after putting up the biggest chunk of a €750 billion (around $1 trillion) package to save Europe's common currency from the Greek financial contagion, the German chancellor gave voice to a set of pro-European musings straight out of the post-World War II dream factory. European unity, she said in a May 13 speech, is the "most tantalizing, magnificent, auspicious idea." Not only must Europe forge a genuinely integrated economy, she declared, but it needs "a common European army."

Reality soon burst the bubble. Beer-garden rage at the idea of throwing hard-earned German money after bad Greek debt gave Merkel's popularity numbers a kick. If an election were held today, polls show, Germany's first woman leader would not win. It's a reminder that in Germany, which is still straining under the financial and social costs of unification, good deeds that further the cause of Europe offer no political payoff. The people who shattered Europe, then helped rebuild it, like the Continent just the way it is.

"Even in the absence of this crisis, Germany would be placing itself in the camp of the stand-pat, conservative powers," says Jeffrey J. Anderson, a professor at the Georgetown University School of Foreign Service in Washington. A rebounding economy gives Germany "even less incentive to do anything risky on the European front. The Germans are standing back and saying: We fixed our problems with fiscal rectitude and a sober, conservative approach, and the rest of you ought to be following suit."

A child of Communist East Germany,

In Germany, furthering the cause of Europe offers no political payoff

Merkel, 56, lacks the emotional roots of the war-scarred German generation that built the European Union to be more than a marketplace. Konrad Adenauer bound Germany to the West in part to protect his country from itself. Helmut Kohl regarded German and European unity as two sides of the same coin—a coin that he made sure was denominated in euros. It is this legacy that Merkel is now struggling to uphold.

Merkel, a trained physicist, had her political awakening when the Berlin Wall fell. Within a year she was in the first all-German government as minister for women and youth, courtesy of Kohl's eye for eastern talent. Her rise was so quick that she skipped the intensely local politics that gave her predecessors grassroots credibility. She also displayed a ruthless streak. When news broke in 1999 that Kohl had run a slush fund during 16 years as chancellor, Merkel, by then secretary-general of the Christian Democratic Union, publicly denounced her mentor.

Now Merkel is bound by the institutions Kohl created: the EU and the euro. As Greece veered toward default and threatened to drag Spain, Ireland, and Portugal down with it, the pressure on the euro drove the equivo-

ANDREAS MUEHE/AGENTUR FOCUS; DATA: GOETHE INSTITUTE

Average salary of a worker in the former East Germany, vs. peers in the West: 83%

cating Merkel to rescue the system not because she loves Europe, but because Germany is its leading beneficiary.

While Kohl battled to keep German and European interests in perfect alignment, he was also the consummate domestic political opportunist. He dodged and weaved for months in 1990 before recognizing Poland's border with Germany as inviolable—the same kind of fence-straddling Merkel was accused of when Greece pleaded for help. And by the end of his tenure in 1998, Kohl, with his treasury buckling under the cost of subsidizing the East, was making idle threats to stop paying into the EU budget.

So when critics—including many from her Christian Democratic base—expressed outrage over Merkel's handling of the debt shock, the complaints were "massively exaggerated," says Horst Teltschik, 70, a Kohl confidant who negotiated German unification. "It would be superhuman to act immediately and know all the answers in such a crisis. Helmut Kohl wouldn't have done it differently. Just like Chancellor Merkel, he would have been willing to take risks in order to preserve the euro.''

Merkel, the overnight political phenomenon, lacks her patron's gift for milking a European crisis for gains at home, and now she is paying the price. In May the CDU lost control of North Rhine-Westphalia, Germany's largest state, and with it a majority in the upper house of Parliament. A rare contested vote almost upended Merkel's candidate for Germany's ceremonial presidency. Battles with her coalition allies over taxes stirred talk of a leadership vacuum less than a year into her second term.

The fiscal crisis and cleanup operation confirmed Germany's preeminence in Europe. It also made the German people even more hesitant to embark on new EU ventures: 53 percent regard the euro as a "bad thing," according to a June poll by the German Marshall Fund of the U.S.

Merkel is not the only reluctant leader the country has seen. Hesitancy was hardwired into Germany's postwar politics as the nation did penance for the crimes of the Nazi regime. Its response was to wield power through the EU, in tandem with former archenemy France. That worked as the EU grew from 6 countries in 1957 to 15 in 1995, and it worked for the creation of the euro in 1999. But things are different in today's larger bloc. Defeats for German-French projects used to be rare; now they are increasingly common, as when other governments rejected France and Germany's argument for a European financial transaction tax on Sept. 7. "For a long time the German-French relationship has been much more appearance than reality," says Günter Verheugen, 66, Germany's EU commissioner from 1999 to 2010. "The days are gone when a German-French directorate could set the course of European integration."

It's not only a numbers game. German and French interests have been drifting apart since the end of the Cold War. As France tapped on the brakes, Germany was the prime mover behind the EU's expansion to the east, seeing it not only as a moral imperative but as good for business. Eastern Europe bought 11 percent of German exports in 2009, trumping the U.S.'s 7 percent share. The eastward shift in the EU's center of gravity also reestablished Germany's buffer zone to Russia.

As doubts swirled around the euro, the French were the first to accuse Germany of having benefited unfairly. Europe's economic imbalances weren't due only to peripheral countries living beyond their means, French Finance Minister Christine Lagarde said in March. Germany was also at fault for saving too much, the argument went, spending too little, and getting rich off exports to the rest of Europe.

Merkel bristled at the charge that Germany, by boosting its industrial competitiveness, was winning a zero-sum European game. One prong of Germany's export model is to invest in factories abroad. Some 64 percent of that investment is in the EU, sustaining 2.9 million jobs, according to Deutsche Bundesbank data. "The export model directly benefits other countries," says Heleen Mees, a researcher at the Erasmus School of Economics in Rotterdam. "It's very worthwhile for those countries to have German factories and technologies."

Germans' support for Europe has eroded: Just 50 percent call EU membership 'a good thing'

Merkel has won on one point. As the EU tries to strengthen the euro region's financial management, the onus is on weaker countries to improve how they do things, not on Germany to abandon fiscal rigor and loosen the lid on wages. Yet that's about the only point she has taken so far. German calls for harsher sanctions on deficit offenders face resistance, and German pleas for an "orderly" default mechanism for debt-swamped countries are going nowhere.

It's no wonder that German enthusiasm for Europe has soured, with the proportion calling EU membership a "good thing" plunging to 50 percent from 60 percent in an EU poll in May. That attitude underpins a tough German stance against increasing the EU's annual €123 billion budget. Grand European projects—such as joint bond issuance or a centralized foreign or immigration policy—fail to excite a country that, after centuries of strife, is at last satisfied with its place on the map.

While consenting to the EU's unhurried expansion to the Balkans, Merkel has transformed Germany from being a supporter of Turkish membership to a die-hard opponent. The best Turkey can hope for is a "special relationship," she said in Istanbul in March. Even in her Europe-of-the-future speech in May, the message was that the EU had enlarged too far and too fast.

What about the Europe of the present? It can look to Merkel's Germany for crisis management, if not for bold steps that go beyond the status quo. "When the crunch comes and there's a crisis, Europe takes action," says Hans Eichel, 68, German Finance Minister from 1999 to 2005. "I'd like to see us make progress not only when there's a crisis, but day in and day out. For that we need politicians with a passionate commitment, not politicians who just react to crises." **B**

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They're Still Making What?

The "Heiss" List

Photograph by Thomas Hannich



Only 17 percent of East German companies survived the enhanced competition of the Western marketplace, according to a 2009 MDR-Werbung study. Today "ostalgie"—a new German word combining "east" and "nostalgia"—bolsters those brands: 80 percent of MDR survey respondents in the former East said their purchases were based more on familiarity than on product quality. Here are some old favorites still chugging along.

Thüringen-made **Zeha** sneakers, once the footwear of choice for East German and Soviet Olympic athletes, went out of production in 1993. In 2002 two Berlin designers revived the brand, recreating the retro Zeha shoe in fine Italian leather. Today the Eastern-bloc revivals sell for as much as $300.

Created by government edict in 1956, **Vita-Cola** was East Germany's answer to the bourgeoise hegemony of Coca-Cola. After reunification it disappeared from store shelves for four years before being brought back by Thüringer Waldquell, its bottle design unchanged but its recipe altered to use natural rather than artificial flavors.

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Philip Morris acquired Dresden's former state-owned cigarette factory in 1990 and began producing the East German brand **f6** (as well as Karo and Juwel). Today, f6 stands out as a signifier of Berlin boho style.

In 1990, 1 million of these scrappy little cars—made of plastic, cotton, and wood—clattered along German roads. Today, 35,000 still ply the highways. The **Trabant** has enough die-hard fans that in 2009, Zwickau-based IndiKar revealed plans to make an updated version of the iconic rattletrap.

After a post-reunification sales slump, this sparkling wine drew such strong demand that the company in 2009 upped production, to 104 million bottles a year, from 15 million in 1990. **Rotkäppchen** means "Little Red Riding Hood" and refers to the 2009 bottle's red top. —*Caroline Winter*

What Drives the German Economy?

New Rules And Old Companies

As most developed nations stumble in the race against emerging nations, here's how Germany, almost alone, has succeeded in keeping skilled labor working in good jobs

By Gabi Thesing, Jana Randow, and Aaron Kirchfeld

In German, *die rote Laterne*—the red lantern that hangs off the caboose of a train—is slang for last place. Less than a decade ago, Germans were wondering whether that was an apt description for their own dawdling nation. Germany produced top-quality technology but seemed held back by an aging, risk-averse population and a sclerotic business culture. In 2005, Germany's 10-year growth rate was half, and its unemployment rate more than double, that of the U.S. rate The *Mittelstand*—Germany's small and midsize manufacturers, often family-run—seemed like a relic of Europe's industrial past.

That has changed. Germany is now growing faster than the U.S. and has a lower jobless rate (7.6 percent in August vs. 9.6 percent). In the second quarter its economy bloomed at an annualized pace of 9 percent. On Sept. 16, the Federal Labor Agency's IAB research institute predicted that, despite a shrinking working-age population, Germany is set to have the highest number of people working since reunification. While the U.S. flirts with Japanese-style deflation, Germany's looming problem is worker shortages. "The German economy remains the showcase of the euro zone," Carsten Brzeski, an economist at ING Group in Brussels, says.

Germany is Europe's largest economy, with 82 million people and a €2.4 trillion ($3.23 trillion) gross domestic product, sprawling from the Rhine to the Oder—the hinge between the European Union's East and West.

Its newfound success was two decades in the making. Early on, in 1990, reunification opened the door for massive investment by German companies, mostly in the former East Germany. In 1999 the adoption of the euro, which overvalued the deutsche mark, forced German companies to cut costs and increase productivity to compete in the export market. More significantly, labor market measures begun in 2003 under Chancellor Gerhard Schröder made it easier to hire and fire workers, and Germany's *Mittelstand* have proved nimble competitors. In its achievement, Germany may serve as a model for other Western economies competing with emerging markets.

German corporations saw reunification as a chance to grow. It energized the nation's businesses, says Karl-Ludwig Kley, chief executive officer of Merck KgaA, a family-controlled drug and chemical company that shares historic roots with Merck. "Reunification has given the German economy a serious boost in terms of investment, entrepreneurship, and a sense of creating something new," he says.

Labor reform played an important role. In the early 1990s multinationals such as Siemens and Volkswagen coped with a global slump by brokering deals with unions that allowed them to opt out of collective wage agreements. In 1994 companies got out from under rules that limited temp workers' tenure to just six months, after which they had to become permanent workers with full benefits. Such deals, combined with the introduction of the euro in 1999, produced short-term costs for Germany but long-term benefits, allowing companies more flexibility in hiring.

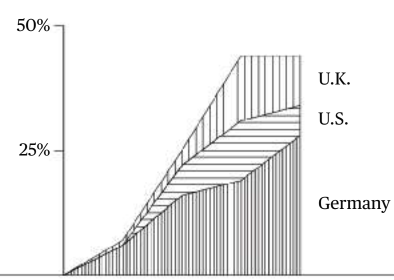
It was a start. Germany still had a long way to go. By 2003, Chancellor Schröder—known as the "Basta Chancellor" for his uncompromising ways—had had enough. The economy was in another recession, unemployment was high, and the social welfare system was underfunded and close to collapse. Schröder, leader of a left-leaning coalition of the Social Democrats and the Green Party, threatened the trade unions: If they didn't voluntarily agree to new wage and hiring rules, he would make them into laws. This allowed companies to break onerous wage agreements. For their part, German labor unions gave up wage increases in return for job security. In November 2004 workers at Volkswagen, which had posted seven straight declines in quarterly profits, agreed to wage freezes and cost cuts worth €2 billion.

PETER TURNLEY/CORBIS; DATA: SH+C WAGNER BUMES WINKLER; NRW.INVEST; IFO INSTITUTE FOR ECONOMIC RESEARCH AND THE INITIATIVE NEUE SOZIALE MARKTWIRTSCHAFT; ERNST&YOUNG; WORLD BANK; FEDERAL STATISTICS BUREAU

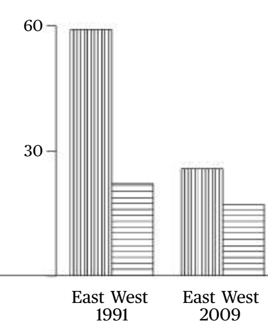
Solidarity Tax
The current rate assessed on both personal and corporate income taxes that Germans have paid since 1991 to help fund the reconstruction of former East Germany is:

5.5%

GDP growth from 1990 to 2008



Hours to generate $1,000 of output



True PDF release: storemags & fantamag

In 2009 unemployment in former East Germany was 14.5%. In former West Germany it was **7.8%**

Schröder's campaign for labor market flexibility culminated in 2005 with a reform package called Agenda 2010. Trade unions hated it because it compromised Germany's "cradle-to-grave" safety net by cutting jobless benefits, asking workers to pay a small part of their health-care costs, and putting more pressure on the unemployed to take low-paid work or employment outside their area of training.

These reforms "would have been unthinkable until 2002," says Christine Trampusch, a professor of comparative politics at the University of Bern in Switzerland. "They only happened because the Chancellor stopped asking the trade unions' permission and instead relied on a coalition between business and the state to push the reforms."

By a measure of worker productivity per euro spent, Germany became 13 percent more competitive against its neighbors in the 11 years through 2009, according to the European Central Bank. "Agenda 2010, which created a low-wage sector, was crucial in terms of laying the foundations for the current employment boom," says Hans-Werner Sinn, president of the Ifo Economic Research Institute in Munich, which advises the government.

Although they worked, the tough reforms compromised Schröder's popularity. Angela Merkel, who succeeded him in 2005, reaped the benefits. For a time, stronger growth produced soaring tax revenues. Then the global financial crisis hit. German exports plunged, and companies feared they would have to lay off thousands. Merkel, though a Christian Democrat and economic conservative, pushed through employer subsidies to reduce layoffs.

As the global economy recovered, German companies were ready. By June 2010, Daimler, BMW, and Volkswagen's Audi unit were adding employees and cutting summer factory breaks as demand for luxury cars returned more quickly than expected.

It wasn't just large multinationals fighting for labor reform or driving the economy. The *Mittelstand* companies, which typically employ fewer than 500 workers, comprise more than 70 percent of German workers and contribute roughly half of the country's GDP. The *Mittelstand* also embodies the German approach to business practice—paternalistic, consensual, conservative, and arguably more effective over the long haul than what Germans sometimes dismiss as American-style cowboy capitalism.

Far from being relics of a simpler time, *Mittelstand* companies have emerged as successful models in an era of globalization—agile creatures darting between the legs of the multinational monsters. Their blend of high technology, long-term thinking, and focus on quality has helped German manufacturing through the recession. "The continuity of Germany's *Mittelstand* is a pillar of society that has helped avoid a surge of unemployment during the latest crisis," says Hans Jäckel, an economist at DZ Bank in Frankfurt, the central institution for cooperative banks. "The labor market has been lucky because of the *Mittelstand*'s long-term focus."

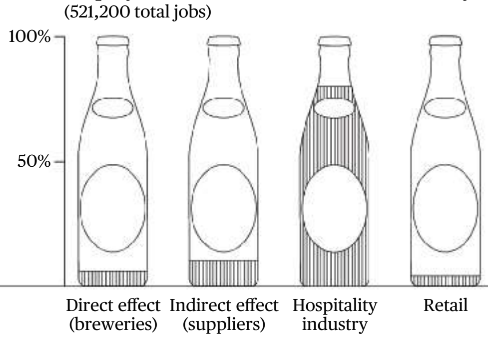
The *Mittelstand* approach encourages and benefits from a strong sense of social responsibility. Government policy helped *Mittelstand* companies hang on to workers through the 2008-09 recession. Rather than firing workers, companies reduced hours, saving almost half a million jobs. Under a government-subsidized short-work plan, or *Kurzarbeit*, companies were able to move employees temporarily into abbreviated working weeks. The government paid employees up to two-thirds of the money they would have made had they worked their normal hours. *Mittelstand* companies also took advantage of a system of worktime accounts that enabled employees to work fewer hours without a reduction in pay, in exchange for promising to work more hours without a salary increase when business picks up. The aggregate effect was lower unemployment—and a quicker response when the global economy turned around. By May of this year, unemployment in Germany was at 7 percent, a 17-year low.

Mittelstand companies also resisted the credit crisis better. Traditionally, they prefer bank loans to selling bonds or issuing stock, avoiding short-term pressures from bondholders and shareholders. To keep the financing flowing, Merkel in December 2009 met with leaders from the banking industry to ensure that

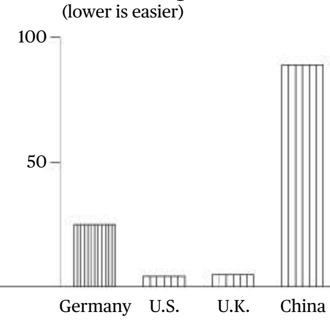


Schrőder's tough ways earned him the moniker "Basta Chancellor"

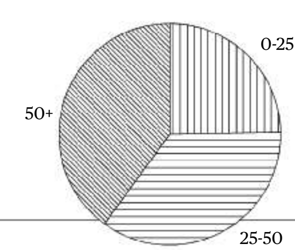
Employment attributed to beer in Germany
(521,200 total jobs)



Ease of doing business
(lower is easier)



Age of population



DATA: IFO INSTITUTE FOR ECONOMIC RESEARCH AND THE INITIATIVE NEUE SOZIALE MARKTWIRTSCHAFT



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Mittelstand at work: At family-owned organ builder Jaeger & Brommer, 19 employees make about one instrument a year

Photograph by Thorsten Futh

companies were getting sufficient funding. Savings banks increased lending last year, while state-owned development bank KfW Group made €40 billion in loans available as part of the government's economic stimulus program. Deutsche Bank and Commerzbank, the country's two largest financial institutions, set up separate funds to ease financing for the *Mittelstand*.

All this ensured that, even at the height of the financial crisis, the *Mittelstand* had access to financing. "There never was a credit crunch," says Patrick Adenauer, a grandson of former Chancellor Konrad Adenauer and president of the German association of family-owned companies known as ASU. Says Adenauer: "The German economy is financed long-term, and that's part of our culture and shouldn't go lost even if the Anglo-Saxons always tell us it's hogwash."

All of this is not to say that Germany has solved its economic problems. Adam Posen, a senior fellow at the Peterson Institute for International Economics and a member of the Bank of England's Monetary Policy Committee, wrote a paper in 2003 called, "Is Germany Turning Japanese?" He says that the country appears to have dodged the stagnant fate of Japan, but that doesn't mean its future is certain. Germany, Posen says, remains overly dependent on exports, as does China. Similarly, he says, the nation's wages are too low, depressing domestic consumption. "The issue isn't Germany turning into Japan now," says Posen. "The issue is Germany turning into China." Some German economists have made a similar diagnosis. "Fundamentally, it was wage restraint over the last 10 years that's responsible for Germany's success," DZ Bank Chief Economist Stefan Bielmeier says. "It's questionable whether that model is sustainable going forward."

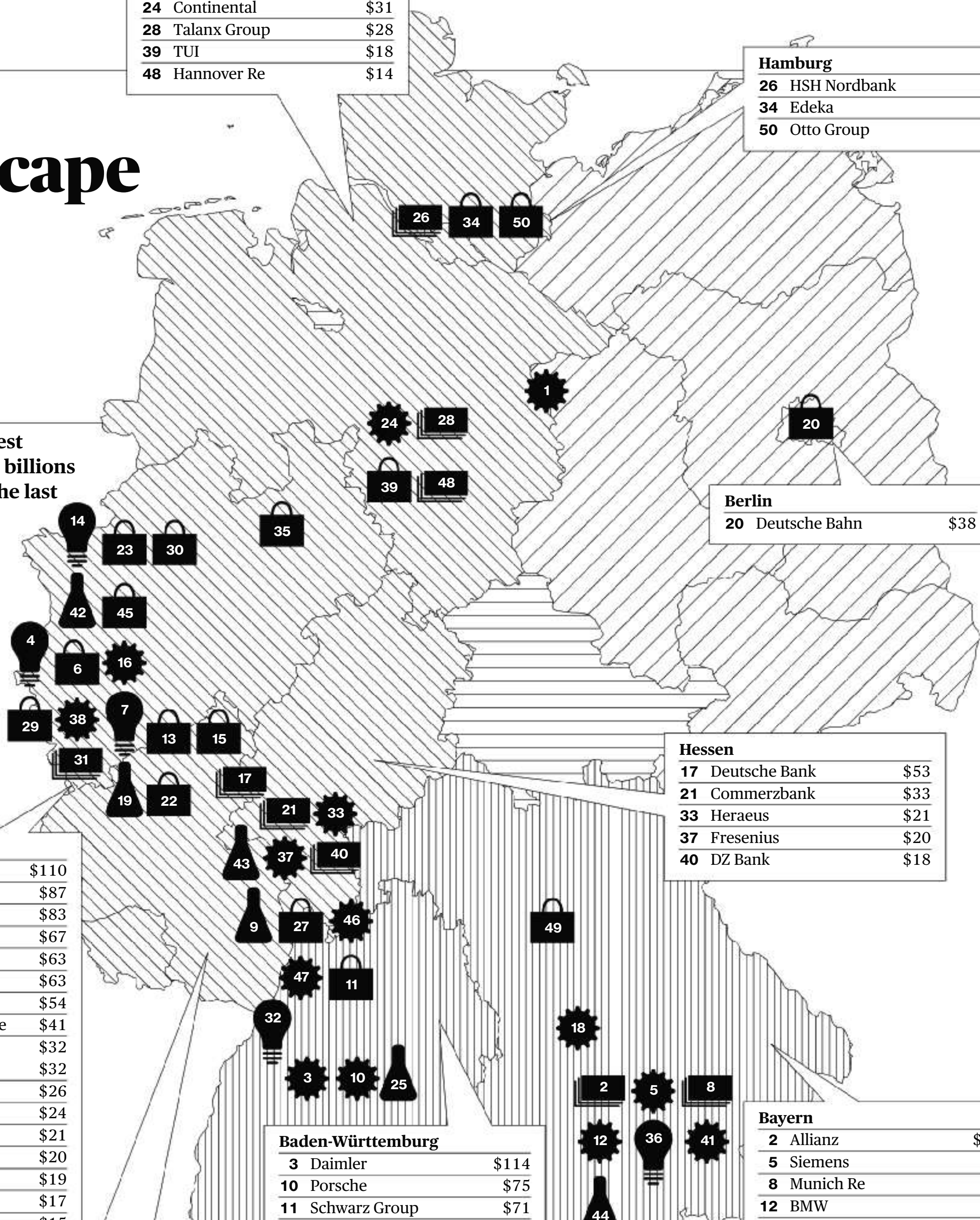
Every mature economy, of course, has its challenges. Germany has managed its particular issues better than most of its peers. At least, says former Finance Minister Peer Steinbrueck, "Nobody is talking about the consumptive sick man of Europe anymore." B

—*With Simon Berberich and Alex Webb*

The Workscape

Who's earning, and where?

By province, the largest employers ranked by billions of dollars earned in the last 12 months



Niedersachsen

1	Volkswagen	$152
24	Continental	$31
28	Talanx Group	$28
39	TUI	$18
48	Hannover Re	$14

Hamburg

26	HSH Nordbank	$29
34	Edeka	$21
50	Otto Group	$13

Berlin

20	Deutsche Bahn	$38

Hessen

17	Deutsche Bank	$53
21	Commerzbank	$33
33	Heraeus	$21
37	Fresenius	$20
40	DZ Bank	$18

Nordrhein-Westfalen

4	E.ON	$110
6	Metro Group	$87
7	Deutsche Telekom	$83
13	REWE Group	$67
14	RWE	$63
15	Deutsche Post	$63
16	ThyssenKrupp	$54
19	Bayer Material Science	$41
22	Deutsche Lufthansa	$32
23	Franz Haniel & Cie	$32
29	Arcandor	$26
30	Hochtief	$24
31	Generali Deutschland	$21
35	Bertelsmann	$20
38	Henkel	$19
42	Evonik Industries	$17
45	Tengelmann Group	$15

Rheinland-Pfalz

9	BASF	$75
43	Boehringer Ingelheim	$17

Baden-Württemburg

3	Daimler	$114
10	Porsche	$75
11	Schwarz Group	$71
25	Celesio	$30
27	Phoenix Pharmaceuticals	$28
32	EnBW Energie Baden-Württemberg	$21
46	HeidelbergCement	$15
47	SAP	$15

Bayern

2	Allianz	$119
5	Siemens	$97
8	Munich Re	$77
12	BMW	$71
18	Audi	$43
36	Thüga	$20
41	Man Group	$17
44	Linde Group	$15
49	Adidas	$14

Industry category

Financial services · Chemicals/pharmaceuticals · Manufacturing/information technology · Retail/Services · Utility

Unemployment

Under 6% · 6-9% · 9-12% · 12+%

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Why Don't Germans Like Stocks?

Chronic Bubble Phobia

When it comes to investing, Germans are about as conservative as they come

By Julie Cruz

At 79, Karl-Friedrich Markwort is old enough to remember the postwar economic collapse that left German currency and equities all but worthless. So it might not seem surprising that Markwort, a retiree in the Frankfurt suburb of Bad Soden, steers clear of stocks.

He was lured into the market once, during the 1990s Internet boom, because he wanted to own "the businesses of the future," he says. By the time Deutsche Telekom, Germany's biggest phone company, spun off part of its T-Online unit in an April 2000 public offering, Markwort was eager to own 500 shares. "I was lucky because I was only allocated 35," he says. He later sold them for a 50 percent loss. "I don't trust the stock market now," he adds. "I wouldn't invest there anymore."

In Düsseldorf, 44-year-old Reinhard Strueven feels the same way. His retirement plan consists of a pension, a bank account, an investment apartment—and no equities. Max Ruehle, 30, a furniture store owner in Wiesbaden who lost €30,000 ($38,424) on stocks from 2001 to 2005, also stashes his cash in the bank. "If I want to play with money, then I go to a casino," he says.

When it comes to investing, many Germans are uncomfortable taking risks. Only 6 percent directly owned stocks in the first half of 2010, according to Deutsches Aktieninstitut (DAI), a shareholder lobby association, whereas stock ownership for the French is 15 percent and 10 percent for the Britons. Only 9.4 percent of the German population owned shares of mutual funds in the first half of 2010, vs. 44 percent of households in the U.S. in 2009. At the end of 2009 stock investments represented 3.9 percent of the financial assets of German households, the lowest level since at least 1991. Instead of stocks, Germans have 28 percent of their assets invested in life insurance products, 18 percent in cash and short-term deposits, and 20 percent in bank deposits.

Some of Germans' reluctance to sink their money into equities is a result of the structure of the retail banking system, which is dominated by locally owned savings banks and cooperative lenders. As a result, investment advice tends to be more conservative than in other Western economies. But it's the 2003 implosion of the Neuer Markt—a technology-focused exchange that had launched four years before—that truly frightened people away from the stock market. There was also a series of money-losing IPOs: In 1996 the Kohl government privatized Deutsche Telekom, and shares surged from €14.57 in the 1996 public offering to €102.9 in March 2000, before the dot-com bust shattered the price—and Germany's fragile investing confidence along with it. Today, Deutsche Telekom still trades below its IPO value. Shares of Deutsche Post, Europe's biggest mail carrier, followed a similar pattern, selling for €21 each in a 2000 IPO. They're now worth little more than half that.

Since German reunification in October 1990, the DAX has more than quadrupled in value, confounding skeptics who said the costs of subsidizing East Germany's crippled economy would cause years of stagnation. So far this year, German stocks have performed better than those in most developed nations. Still, the Germans aren't going for it. "The thinking of the broad population," says DAI director Franz-Josef Leven, "is that shares are here to lose money." B

DATA: BLOOMBERG

The Rebirth of Dresden

What Makes Saxony Run?

Saxony and its capital city have led a renaissance of industry in East Germany

By Leon Mangasarian

Two decades ago, Saxony was as beaten down as the rest of East Germany. In Dresden, its capital, fire-bombed Baroque palaces and museums had been partially rebuilt, but raw sewage still poured into the Elbe River. Telephones were rare. Young people longed to move West to escape shortages and censorship. There was some manufacturing: Saxons made East Germany's flimsy Trabant, but the sedan was so unloved, people joked that it doubled in value when filled with gasoline.

Today, Saxony is one of the brightest stars in the East. Saxons build BMWs, Porsches, and Volkswagens, chips, and watches from A. Lange & Söhne that cost up to $500,000 apiece. Gross domestic product has grown 11.2 percent since 2000, a higher rate than any of Germany's other 15 federal states, according to data from the state's Economy Ministry.

Saxony's dramatic gains owe much to pro-business government policies that unleashed the famous Saxon work ethic, inventiveness, and attention to detail. "Our companies have been very good at carving out niches and customizing products," says Saxon Econ-

Known number of people between 1961 and 1989 who died attempting to cross the Berlin Wall: 136

omy Minister Sven Morlok. Two key figures in the transformation were Kurt Biedenkopf, now 80, the Christian Democrat who served as premier from 1990 to 2002, and the late Kajo Schommer, who served as economy minister during the same formative period. Together they developed a "lighthouse principle" in which industries with high potential—especially autos and microelectronics—got most of the state aid.

"The state's political and business leaders boosted the self-confidence of the Saxon people and convinced them their fate was in their own hands," says Joachim Ragnitz, managing director of the Ifo Institute for Economic Research in Dresden. "It was like nation-building, and it worked. They got people to believe that they really had to be best at whatever they were doing."

The Saxon government threw its support behind Volkswagen, the first big West German company to make a major investment in the region. In 1990 the company decided to produce the VW Polo compact car in Zwickau and since then has built some 3 million cars and 8 million motors at factories in the state. Saxony had three things going for it at the time: Volkswagen's chief executive officer, Carl Hahn, was a Saxon native. It had carmaking experience (in spite of the Trabant). And VW got big subsidies, half from the federal government and half from the state. VW's investment attracted parts suppliers and ultimately other automakers to the state.

The other breakthrough investment, in 1995, was by German manufacturing giant **Siemens**, which was also drawn to Saxony's pro-business climate and skilled workforce—a legacy of the communist-era, Saxony-based computer-maker VEB Kombinat Robotron. As with VW, Siemens opened the floodgates to other investments in the sector. In the late 1990s, **Advanced Micro Devices** began building computer chip factories in Dresden. The Dresden manufacturing campus, now owned by an AMD-Abu Dhabi joint venture called Globalfoundries, is the largest chipmaking center in Europe and one of the most advanced in the world.

"AMD was set to go to Ireland, and that investment was diverted to Saxony because of Prime Minister Biedenkopf and his team," says Jens Drews, Globalfoundries' director of government relations. "They were visionaries."

With 4.2 million people, Saxony sits in an eastern nook of Germany, with the Czech Republic to the south and Poland to the east. Twenty years after reunification, about 6,000 companies have invested €27 billion ($35 billion) in the state, which is smaller than New Jersey. East Germany's anticommunist mass protests had their genesis in the Saxon city of Leipzig in 1989, paving the way for demonstrations that swept the hard-line state before it imploded that year. As a result, Saxon voters have not elected any former East German communist to power as part of any coalition government.

The local government has taken market-friendly steps that would be unthinkable in other parts of Germany. In 2006, for example, Dresden's municipal government sold 48,000 apartments to U.S. buyout firm **Fortress Investment Group** for €1.75 billion. This was a year after Franz Muentefering, then leader of the Social Democratic Party, compared such investors to the biblical plague of locusts that descended on Egypt.

Dresden, which was the first German city to sell all the housing it owned, used the proceeds to pay back debt of more than €700 million, and it remains debt-free. "The Saxons have been clever business people for centuries," says Carl Graf von Hohenthal, a management adviser at the Brunswick Group in Berlin and former deputy editor-in-chief of *Die Welt*. "The typical Saxon is constantly thinking about how he can do business. When you drive across the border from Brandenburg into Saxony, you immediately see the difference. The villages are cleaner and more prosperous, the church towers bigger and higher."

Saxony's local government has taken market-friendly steps that would be unthinkable in other parts of Germany

Porsche's plant is a symbol of the new Saxony, employing 640 people on the site of a former Soviet military training base. It churns out 250 Cayennes and 100 Panameras a day. The meticulous attention to detail that makes Saxons good at building Porsches is also an asset for producing luxury products such as watches and fine wine. A. Lange & Söhne, the watchmaker established in 1845 in the village of Glashütte near the Czech border, was expropriated by the communists in 1945 and reestablished in December 1990 by Walter Lange, a direct descendant of the founder. Jerzy Schaper, Lange's CEO, says watches made from gold and platinum—which range in price from €13,000 to €390,000—are selling especially well in Asia. Georg Prince zur Lippe, another Saxon who returned after unification, bought back his aristocratic family's manor house and vineyards in Meissen, Weingut Schloss Proschwitz, that had been seized by the communists. The wines are now served on Lufthansa flights.

Despite its progress, the state did experience its own version of the financial crisis, when state-owned Landesbank Sachsen, now known as Sachsen Bank, became a casualty of the U.S. housing meltdown in 2007 and lost €641.6 million. The Saxony Prime Minister at the time, Georg Milbradt, resigned in 2008 after the bank's near failure, saying he wanted "to prevent further damage both to myself and to others." There are also concerns that aging and depopulation of rural areas could lead to worker shortages, and automobile thefts have skyrocketed. Dresden has also been the scene of the largest neo-Nazi marches in Germany since the 1960s. Eight members of the far-right National Democratic Party of Germany won seats in the 2009 election to the state's 132-member assembly.

Despite these challenges, though, Saxony is a success story, especially when compared to where things stood in 1990. "The Saxons are really hardworking," says Christian Schwinner-Strachwitz, 67, who returned to Saxony after reunification. "They never need a kick in the butt." B

—With Christian Vits, Andrew Blackman, and Alan Crawford

PHOTOGRAPH BY JASPER JAMES FOR BLOOMBERG BUSINESSWEEK

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How Did Siemens Go from Scandal to Success?

"Never Miss A Good Crisis"

Shaking off international disgrace and a $1.6 billion fine for bribery, Siemens, under Chief Executive Peter Lőscher, is competing to build the world's infrastructure

Peter Lőscher, 53, the head of Siemens, Germany's largest engineering company, spends as much as 70 percent of his time on the road. "It's the life of a global CEO," he says. These days more and more of his time is spent in China, where Bloomberg Businessweek *met with him on the 62nd floor of the Park Hyatt in Beijing, high above the city's plush Chaoyang District.*

"We are in China since 1872," says Lőscher, an Austrian with salt-and-pepper hair and the build of a former volleyball player. "We have more than 40,000 people in China, 16 R&D centers, more than 3,000 researchers. We are proud when the Chinese premier says Siemens is a Chinese company."

China's boundless appetite for clean energy is the key to Lőscher's green strategy, which is to sell every kind of technology, from trains to windmills to solar panels to building controls, that a giant like China—or Brazil, or India, or even the U.S.—could want. In an interview condensed here, Lőscher spoke on a range of topics.

A German barometer for the global economy.
We are a broad-based infrastructure company, and we focus on three major sectors: health care, energy, and industry. We operate in 190 countries. So we probably are a good barometer, though there are several sectors we simply are not in: telecommunication markets around the world and so forth.

Going global.
Siemens is an infrastructure company. And it is absolutely and perfectly tailored for the infrastructure needs of emerging economies. The key thing is that Siemens is the most global industrial company in the world. And it's not just all of a sudden in the year 2010 we found out—ooh, emerging markets is a great opportunity. We are in Russia since 1853, in India since 1868. So in many, many of these key emerging markets we have been there well over 100 years. And if you look into the composition of our global structure, you will immediately find that roughly a third of our product portfolio and our turnover is coming out of emerging markets. We have more than 100,000 people working in emerging markets. [We're] at home in 190 countries of the world.

Three pillars.
We have three pillars that we have defined the company around. The first is the aging population around the world, what it means in terms of earlier detection of disease—the whole diagnostic paradigm.

The second is energy. And the only company that has a fully integrated energy value chain—from energy generation, transmission, distribution, and consumption—is Siemens. The third is everything around industrial productivity, and that's the major focus, including the whole area of transport systems.


Siemens CEO Lőscher

History.
The company was founded in 1847 by three brothers. One stayed in Berlin. The second went to St. Petersburg. The third one went to London. At that time these pretty much were the centers of the world. So we were founded as a global company, with one technology: the telegraph. And we moved it from Germany to Finland to Russia, to the Black Sea, across the channel, to India, and in 1872 we arrived in the United States. Engineering prowess combined with entrepreneurial spirit is our founding DNA.

On the Financial Times report that, during a meeting with Chinese Premier Wen Jiabao and German Chancellor Angela Merkel, Lőscher, along with BASF CEO Jűrgen Hambrecht, "attack[ed]" China over its protectionist stance.
Let me clarify, because it was totally misrepresented in the press. It was an excellent, excellent state visit by Chancellor Merkel with the premier. And we had a very open dialogue between major Chinese companies, German companies, in the presence of the chancellor and the premier. So what subsequently came out was totally misrepresented by people that never participated in the meeting. Quite frankly, everything was around innovation. There is no other country in the world that has seen a transformation like China went through in the last 30 years.

Green portfolio.
We are the company with the biggest, deepest, and broadest green portfolio, with the objective by 2011 to hit €25 billion [in sales]. We will surpass this target already by the end of this year. We have more than 100,000 people working on this portfolio. In research and development we are spending every year more than a billion euros [on energy], from a total R&D spend of €3.9 billion. We have 16,000 patents behind this

DATA: BERLIN WALL MEMORIAL AND THE CENTER FOR HISTORICAL RESEARCH IN POTSDAM

product portfolio, out of a total patent portfolio of 56,000. And it was a major growth driver at the height of the financial crisis. In 2009 our green portfolio grew 11 percent.

Green China.
China has a very, very ambitious but very clear energy plan. We just deployed 1,400 kilometers [870 miles] of high-voltage direct current transmission line from Yunnan down to Guangdong, with an overall transmission loss of 5 percent.

By 2050 the target of China is to have renewable energies be 25 percent of their energy mix. As they change their energy mix, we are able to help in all areas.

The Chinese boom.
When I was studying at the Chinese University of Hong Kong in 1984 and I was for the first time visiting Shanghai, you saw rice fields, you saw hardly a car. In today's environment, if you take the signage away from Shanghai, it could be anywhere in the world. So the transformation of China is remarkable. Since the WTO access alone, the GDP per capita has grown 226 percent. So I have enormous respect for the changes which are happening.

Bribery scandal and turnaround.
Never miss a good crisis. And we certainly didn't miss our crisis. We are extremely proud that Siemens today is recognized today by prestigious external parties like the Dow Jones Sustainability Index as the No. 1 industrial company in the world. And we always say Siemens stands for clean business, every time, always, and everywhere. So we are recognized as a leader in this field—which obviously was one major achievement.

We are communicating a record order book, the biggest order book in the history of the company. Our growth profile is significantly better than many other industrial companies. We will report record profit this year. So despite the big crisis, I am hugely proud of the performance of all 405,000 Siemens workers. And it has proven three things: We have clarity of strategy, clear direction, and we are playing to our strengths. B
—As told to Dexter Roberts

How Does It Feel To Be a Turk in Germany?

A Merger In the Shadows

Turks are successful businessmen, scapegoats, needed workers, and inner-city problems. To be Turkish in Germany is truly to straddle worlds

By Tony Czuczka

When Avni Yerli and his two brothers started a computer-game company called Crytek in their Bavarian hometown of Coburg in 1999, it never occurred to them that their Turkish immigrant roots could hold them back. Germany was a digital "backwater," Yerli says, so they set their sights on international success.

The brothers were well educated (Avni had been working as a building engineer; his brothers had business degrees), and the family had made a bit of money (their father, Mustafa, worked in a furniture factory). So when venture capitalists refused to back them—not because of their ethnicity, Yerli says, but because German VCs "didn't understand what we wanted to do"—the brothers and various family members came up with €100,000. They used it to develop and market technology, called CryENGINE, which powered their first video game, published by UbiSoft Entertainment. By 2006 they had moved into a converted red-brick factory in Frankfurt and had built the privately held company into Germany's largest video-game maker.

The brothers don't think of their company as Turkish or German. "We wanted to create an international corporate culture right from the start," says Yerli, 40, who now helps manage 650 employees at Crytek studios in six countries including Britain and South Korea. The company's lingua franca is English. "The German element, if you will, is to do good planning, analyze sharply, and focus on quality."

With an estimated 3 million residents of Turkish descent and a shrinking, aging population, Germany has reason to capitalize on its largest ethnic minority. Instead, it has spent the summer indulging in an angry debate about whether poorly educated Muslim immigrants are making Germany "dumber" and singling out the Turkish minority as most resistant to assimilation. Those incendiary assertions were made in *Germany Is Wiping Itself Out,* a best-selling book by Thilo Sarrazin, a former Bundesbank board member and previously Berlin city treasurer. The book's August publication brought fierce criticism from mainstream politicians, yet in a Sept. 8 Forsa poll, 61 percent of respondents said they agreed partly with his arguments, while 9 percent said they agreed fully. Just 22 percent said his comments were unacceptable.

Concurrently, a 40-year immigration trend is now reversing itself: Some 40,000 people left Germany for Turkey in 2009, while only 30,000 emigrated from Turkey to Germany, according to the federal statistics bureau. Second-generation Turks who leave Germany tend to be well educated and can afford to vote with their feet. Yerli says he was "surprised and disappointed" by the Sarrazin episode. "I would have expected a bit more depth to the debate," he says. "Germany really can't afford this. I would have thought that Germany has left that kind of thing behind." ("Even so," he adds, "I'm not thinking of emigrating.")

The first wave of Turks in Germany—unskilled, poorly educated *Gastarbeiter*, or "guest workers," recruited in the 1960s to fuel West Germany's post-World War II boom—could scarcely have dreamed of Yerli's lofty attitude or his success. Today, Germans of Turkish descent are making it to the top in politics, the arts, sports, and academia.

KARSTEN SCHOENE/LAIF/REDUX

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519

Number of Olympic medals East Germany won, from 1968 to 1988. West Germany won 253.

When soccer player Mesut Ozil scored for Germany at the 2010 World Cup in South Africa, fans back home didn't care where his parents were from. Cem Ozdemir, whose Turkish-born mother once worked as a seamstress in southern Germany, became the nation's first federal lawmaker from an immigrant family in 1994 and now heads the opposition Green Party, which is polling at a record high.

Turkish-Germans run some 80,000 businesses that employ, on average, five people. Still, they're only about half as likely as Germans to start companies, according to the Turkish Community in Germany, an advocacy group.

Driving anti-immigrant sentiment is a large, unassimilated Turkish underclass living a ghettoized life in urban centers such as Berlin, Hamburg, and Bremen. Like alienated Muslim communities in Britain, France, and Scandinavia, the Turks live in parallel societies—urban areas where Turkish grocers, Turkish satellite television, and Turkish newspapers ease self-isolation. Between 10 percent and 15 percent of the immigrant population is "unwilling" to be part of German society, says Interior Minister Thomas de Maizière, whose department is responsible for immigration affairs.

Immigrant Turks still lag in education, pay, and employment, often falling behind other groups among the 15 million first- and second-generation immigrant residents who make up 19 percent of Germany's population. The Turkish community has the lowest share of high school graduates (14 percent) and an unemployment rate of 23 percent, according to a 2009 study by the Berlin Institute for Population and Development. That compares with a 7.6 percent jobless rate for Germany in August. Turks and their children are twice as likely as Germans to wind up on welfare, and in Berlin they top the police tally of gang criminals.

"Yes, there is discrimination" against non-German job seekers, says Nihat Sorgec, head of a vocational school in Berlin's heavily immigrant Kreuzberg neighborhood. "But whining and feeling victimized is not the best way to fight this. You need to move on and say, 'These are my qualifications, I can do this job better than others.'" His wish is to see "a Turkish manager" among the top 30 German corporations in the DAX stock index within 10 years. "We haven't gotten there yet," says Sorgec, who received the German government's Federal Cross of Merit for his educational efforts. "The reason is the people who were originally recruited to Germany. They didn't bring in managers. They didn't bring in academics. They brought in 'guest workers,' who were supposed to do the dirty work."

Unlocking the potential among immigrants in the world's fourth-largest economy may be critical to securing German prosperity. Chancellor Angela Merkel agrees. Germany should "put the job potential of migrants to better use," she wrote in a Sept. 20 op-ed piece in *Die Welt*. "We can't waste any talent." Asked what non-Germans need to do to get ahead, politicians from Merkel on down reply: Learn German. "Whoever lives among us also has to be ready to integrate into society, learn the language, participate in school," Merkel said in August. "There's a lot to do in that respect."



In Cologne, ads for beer and Erdogan's state visit

Turkish community leaders say Germans need to be more welcoming. Only a decade ago politicians were still debating whether Germany was an "immigration country" at all. In 2000, after the Social Democratic government of Gerhard Schröder changed the country's citizenship law to reflect growing diversity, a leader of Merkel's Christian Democrats called for a "guiding culture" of Germanness. Another complicating factor is Europe's relationship with Turkey, a secular Muslim country that faces German and French objections to its bid to join the European Union.

During a 2008 visit to Germany, Turkish Prime Minister Recep Tayyip Erdoğan told a Turkish audience, "Nobody can expect you to submit to assimilation. Assimilation is a crime against humanity."

Belgin Kaplan, 26, a Muslim, sees no problem straddling the two cultures in Berlin. An employee in her father's *doener-kebab* plant in a gritty western part of the city, which produces a ubiquitous gyro-like meat on a spit that rivals wurst as Germany's dominant fast food, she grew up in the capital, speaks German with a native accent, speaks Turkish at work and with her family, and holds a Turkish passport. "Our life is totally multicultural," says Kaplan, wearing ripped jeans that prompt some ribbing from her father. "We do business here and we live here. I feel accepted as a Turk. The business world is gradually adapting to Turks."

Her father, Remzi Kaplan, says he has built the family enterprise into one of Europe's three biggest *doener* producers after a classic trajectory that began with selling produce in divided 1970s Berlin. "My dad started with a tabletop, two trestles, and a scale," Kaplan, 50, says in an interview during which he serves Turkish tea and sweets. "When we go to Turkey now, my three children say, 'When are we going back home?' They mean Germany." Ⓑ

DATA: "DIE DEUTSCHE SPORTEINHEIT," DOCTORAL DISSERTATION AT THE UNIVERSITY OF POTSDAM

How Not to Embarrass Yourself in Germany

TIPPING



Tip 10% to 15% on big meals. For coffee or small meals, round up to the next euro or half euro.

TITLES



Always use titles, like Doctor, Frau, or Herr. Don't use first names unless invited.

BIRTHDAYS



When it's your birthday, it's your responsibility to provide food and drinks.

PUNCTUALITY



Always be on time. Be direct and detail-oriented.

SMOKING



Never light a cigarette off a candle. A common superstition says doing so kills a sailor.

BATHROOMS



Bathroom attendants are common and expect to be tipped roughly 30c.

DOCTORS



Anyone with a PhD should be addressed as Professor or Doctor.

SUIT JACKETS



Don't remove your suit jacket unless your host does.

ALCOHOL



Drinking alcohol is common, but it's always acceptable to refuse a drink.

MEETINGS



Expect business meetings to be longer than in other countries.

HIERARCHY



Make your status known. Hierarchy is considered important.

DRESS



Wear conservative business attire. Khakis make people think you're sloppy.

GARBAGE



Always recycle. Proper garbage disposal is extremely important to the Germans.

JAYWALKING



Never jaywalk, even if there's no traffic anywhere to be seen.

TOASTING



Make eye contact when toasting. Not doing so is said to bring bad luck.

SITTING



Wait to sit down until you are invited to do so or until others sit.

TAXIS



Taxi drivers don't expect tips, but most people round their fares up to the next euro or half euro.

UTENSILS



Crossing your utensils means you're still eating. Laying them parallel means you're finished.

WATER



Expect to pay for bottled water at restaurants. Ordering tapwater is impolite.

TALKING



Avoid exaggerations and high-pressure talk.

VISITS



When invited to someone's home, always arrive on time and bring a small gift.

HANDS



Keep your hands on the table when eating. To do otherwise is considered rude.

ICONS BY MATT OWENS. DATA: FEDERAL MINISTRY OF ECONOMICS & TECHNOLOGY; GRAFF & SCHAUPP, *MORE THAN MANNERS*; GERMAN FOREIGN OFFICE; BLOOMBERG

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The best gyms and lounges from all over the world
Page 88

Airport Spas & Cameras & New Coke

Etc.



Jackie O's handbags as investments. Seriously.
Page 92



The Return of the Three-Martini Lunch

Whether as an alleged complement to food or a business lubricant, the boozy lunch is making a comeback. *By Joel Stein*

Photograph by Jamie Chung

KENNEDY: MICHAEL OCHS ARCHIVES/GETTY IMAGES

Etc. Three-Martini Lunch

Businesspeople used to know how to waste time. Instead of updating their Facebook wall and shopping on eBay, they ordered three martinis at lunch and headed back to the office four hours later. "Nobody I know does *that* anymore," says Joel Babbit, 57, a longtime advertising writer who recently started Mother Nature Network, an environmental website. Babbitt's first day at advertising agency McCann Erickson in 1977 involved a lunch that began with his very first martini—and ended with his head in a toilet at 2 pm. "There was a time when I had two Bloody Marys at lunch every day," he remembers. "But I haven't had anything to drink before six o'clock in 15 years. Even if I had the desire to do it, I can't stay awake and I can't get anything accomplished."

That's the common gripe against the drinking lunch: It prevents workers from actually doing their jobs. However, from midtown Manhattan restaurants to strip-mall McCormick & Schmick's, professionals are making the drinking lunch work for them. While some hide behind a supposed culinary experience—and some just plain hide it—others, particularly old-timers, have a vested interest in reinstating the institution. To help with business, of course.

Much has changed, though, since the days of Don Draper and Roger Sterling. "Hard liquor has been gone since the '80s, with the last so-called-stock-market crash," says Julian Niccolini, co-owner of Manhattan's Four Seasons restaurant. However, Niccolini claims he now pours a lot of wine at lunch, particularly to parties of four or more. One reason for this, he attests, is that he's seeing fewer judgmental teetotaling diners at lunch. "It's no longer, 'Is somebody going to badmouth me?' That's gone out the window," he says.

"Like sex, someone may find your proposal a lot more interesting after six or seven vodka tonics"

Given the right signal, in fact, restaurateurs claim that most lunch companions seem willing to join in. In Los Angeles, Comme Ça restaurant fills with Creative Artists Agency executives and their clients every afternoon. General Manager Christopher Hennessy says he's never seen ordering a drink socially misfire, even in health-conscious Hollywood. "It'll take one person to make that first tentative order," he says. "Then everyone realizes they're all at lunch for the same reason." Because the restaurant is known for its Prohibition-era cocktails like the whiskey-based Bobby Burns, some people feel they're indulging in a gourmet treat rather than just tying one on. Though several times each week, a table will stretch out lunch until 4 o'clock. Says Hennessy: "A few cocktails takes the pressure off a big deal."

If you have a mixologist making complicated drinks from esoteric-sounding ingredients, people don't even feel guilty that they're drinking. Jon Kamen, chairman and CEO of New York-based production company @radical.media, doesn't. He only goes out to lunch once a week, but when he does, he often goes to EN Japanese Brasserie and orders a drink, such as their combination of Japanese liquor shochu and oolong tea. "They've created certain cocktails that I don't look at as a drink so much as a complement to the meal I'm having," he says. The main reason he agreed to talk for this article is to convince the restaurant to bring back its matcha green tea martini.

Others are supporting the drinking lunch's revival as an assertion of their professional identity. These people are called journalists. Dan Dunn, a journalist and author of the forthcoming *Living Loaded*, has a few drinks at lunch about 10 days per month. "You're sending a very clear message that you're not the kind of guy to be trifled with," says Dunn, who

The Boardroom Boozehound

Lunch can still be splashy. Jordan Kaye, co-author of *How to Booze*, and Jeffrey Morgenthaler, noted spirits blogger and mixologist at Clyde Common in Portland, Ore., advise on how to get tanked without tipping off your co-workers. —*Spencer Bailey*



Clean Up Your Act

Use alcohol-based hand sanitizer so that "your colleagues associate the smell of alcohol with your obsessive-compulsive disorder," says Kaye, "and not your predilection for hitting the hard stuff." Suggests Morgenthaler: "If you can sneak away to the bathroom and do a full toothbrushing, hand-washing, and face-washing routine, you'll be ahead of the game."



Remain Transparent

Stay away from red wine at all costs. It will stain your teeth and give you away to the boss. Heavy liquors like tequila, Scotch, and bourbon will leave a stench that's hard to rid. "Go with the lighter spirits—clear rum, gin, and vodka," says Morgenthaler. White wine works well, too, though avoid a buttery Chardonnay—it'll make your teeth look glossy.

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also argues that the drinking lunch helps people with their jobs. "Like sex, someone may find your proposal a lot more interesting after six or seven vodka tonics." Dunn suggests bringing a pen and paper to write down anything agreed upon that you might forget. And taking a photo of the person you're having lunch with, in case you forget that, too.

While many people in financial services eschew boozy lunches in order to eat at their desks and follow the markets, some have gotten back on the bandwagon, albeit privately—lest they be accused of throwing around their largesse during a recession. "Bankers are drinking in secret. It's sort of Prohibition-esque," says Sebastian Fogg, a former general manager of New York's Monkey Bar and current operations manager for Caprice Holdings, a British-based owner of haute restaurants. "Being the despicable creatures they are, they hide at chefs tables and private rooms and drink as much as possible."

Then there are the professions with a vested interest in seeing the drinking lunch return. "I made my best sales going out to lunch after a presentation where you have an in-depth conversation about what their true needs are," says Ed McCarrick, executive vice-president of Icon International, a division of Omnicom media group that specializes in corporate barter. "Sometimes having a glass of wine or a martini allowed that to happen more easily than sitting in a boardroom where everybody is more guarded." McCarrick began his career as a salesperson at *Time* magazine in 1973 when a bartender used to push a drink cart through the halls. While his lunch companions used to always order drinks, he says, they now do about 20 percent of the time. "In the old days—boom!—scotch on the rocks," McCarrick says. "Now it's mostly wine."

Stalwarts like McCarrick are doing their part to turn back the clock. Mark Johnson, a former lawyer who now produces films, says one pleasure of having his own business is being able to drink at lunch whenever he wants. "If somebody's a client and they're not abusing my credit card, I'll pretty much drink with them all day," he says. Johnson often draws comparisons to *The Big Lebowski's* "The Dude" because of his predilection for White Russians, but he also enjoys peaty, single malt Scotch. "When you're ordering a highball, you're making a statement. A beer you can slip in everywhere," he says. In San Jose, his lunch options are limited to P.F. Chang's and McCormick & Schmick's ("They have some great single malts"). Though when he takes a meeting in LA, he goes to the Hilton in Burbank, a well-known hideout for lunch drinkers. "Places get known for it. It's enjoyable to go there and get martinis at noon. The people who know what's going on know they have cheap drinks. A lot of people still have three-martini lunches there."

"They've created certain cocktails that I don't look at as a drink so much as a complement to the meal"



Draper and Sterling know how to conduct a working lunch

In Europe, of course, no one needs excuses or hideaways. Emil Varda, the part-owner and manager of New York's Waverly Inn, began his career in Paris and opened London's Automat restaurant. His original business plan for Automat was way off, he said, because he underestimated the amount Brits drink at lunch. "At the Automat, there were suits running to the restaurant at noon and ordering two pints per person when they sat down. Very often they'd have a third," Varda says. "In France, it's lunch, so you have to have a glass of wine immediately. But it doesn't really matter; no one in France works anyway."

In fact, Europe is leading the drinking lunch's revival with a grassroots movement. This spring, hundreds of Carlsberg workers struck in protest of a new policy limiting them to one free bottle of beer per day at lunch. However, the Danish company was careful not to go too far. Carlsberg's head of communication noted that it had set up beer taps at factories as consolation. By utilizing this new system, he said, "The employees can certainly manage to drink more than one beer during their lunchtime breaks." Ⓑ



Muddle Your Breath

While at lunch, Morgenthaler suggests munching on something "garlic heavy" followed by fruit-flavored gum rather than mints. "Gum's more active," he says, "and it'll last longer." In lieu of food, Kay says, go for a caffeine fix. "Cigarettes and coffee," he says, "are the best complement to—and mask for—an unrestrained love for daytime cocktails."

ILLUSTRATIONS BY R. KIKUO JOHNSON; TOP: CARIN BAER/AMC/EVERETT COLLECTION

The Airport Perks Arms Race

After a dip at the ATL Marriott, grab some barbecued scallops at One Flew South



Best Architecture: Madrid's Barajas Terminal cost $7.2 billion



Best Pool: Watch the runway at Atlanta's Hartsfield-Jackson

From spas to 24-hour screening rooms, airports are now wooing travelers with some seriously luxurious amenities. *By Geraldine Campbell*

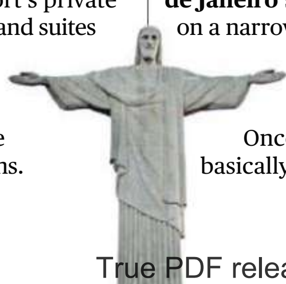
▶ **BUDGET HOTEL: The Citizen M** (from $93/night) made its debut in 2008 at Amsterdam's Schiphol Airport. In addition to providing easy airport access, its *Jetsons*-like vibe includes LED-lit rooms (adjusted using touch-screen mood pads), futuristic rain showers, and extra-large beds.

▶ **LUXURY HOTEL:** The Gaudí-like **Aviator Farnborough** (designed to look like an airplane propeller) is sustained by the Hampshire (England) airport's private jet-setting clientele. Rooms and suites (from $395) are reminiscent of a luxury ocean liner, with free Wi-Fi, movies, and REN bath products. The hotel also offers flying lessons.

▶ **GAMBLING:** Las Vegas' McCarran International Aiport has slots all over. However,... the "hold" here is higher than anywhere else in town (in other words, you're even less likely to win). If gaming is what you're after, the **Golden Gate Casino** is just three minutes from Seoul's Incheon Airport.



▶ **APPROACH:** Flights coming into **Rio de Janeiro's Santos Dumont** land on a narrow waterside strip (requiring special training), with Sugarloaf Mountain looming in the distance. Once you deplane, you're basically in the heart of the city.



▶ **U.S. SPA:** The sleek **Elemis Travel Spa** at JFK's Terminal 7 is geared toward the quick fix: The majority of treatments take just 15 minutes, from the post-trip Flight Rehydrator facial to the Flying Feet, a scrub and hot stone massage. First Class and Club World travelers spa for free.

▶ **INTERNATIONAL SPA:** Hong Kong International's **OM Spa** ($20/weekdays; $25/weekends) includes a gym, steam room, and 70-foot outdoor pool surrounded by cabanas, where—if you have time—you can get an al fresco rubdown.

▶ **U.S. LOUNGE (FOR COST):** Virgin Atlantic's sleek **Clubhouse at San Francisco International** ($35/day) has floor-to-ceiling windows with endless views of the bay. There are also moving glass panels, mood lighting, and digital art—not to mention top-shelf cocktails, a juice bar, and an Xbox station.

MADRID: FERNANDO CAMINO/GETTY IMAGES; CHRIST: ANTONIO SCORZA/AFP/GETTY IMAGES; DUMBBELL: MICHELE CONSTANTINI/GETTY IMAGES; CARDS: HAPA/GETTY IMAGES; PEOPLE: ERIC CABANIS/AFP/GETTY IMAGES; STRUDEL: MEDIABLITZIMAGES (UK) LIMITED/ALAMY

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This man's back could use some love from Hong Kong International's OM Spa







Best Nap: Rent a room for a snooze at London Heathrow's Yotel



Best Domestic Lounge: Relax in the mood lighting and play Xbox at SFO



Best Budget Hotel: Take a rain shower at the Citizen M in Schiphol Airport

▶ **SHOWER AND NAP COMBO:** At London Heathrow, London Gatwick, and Amsterdam Schiphol, **Yotel** cabins can be rented in four-hour blocks. (No, it's not that kind of hotel.) The podlike rooms (from $40/4 hr.) are tiny but comfy, with private baths and storage units.

▶ **PET FRIENDLY:** Miami International Airport has two (soon to be three) fenced-in grassy dog runs. There are also disposal bags and benches (for humans).

▶ **GIFT SHOP:** The **SF MOMA Museum Store** at SFO has something for every last-minute shopper, from environmentally friendly wooden block sets to high-end office tchotchkes and Wayne Thiebaud notecards.



▶ **INTERNATIONAL LOUNGE:** The **Qantas First Class Lounge** in Sydney offers iMac stations and private offices (each with its own printer, television, and lounge). There's a Neil Perry restaurant serving flights of Australian wine to go with your chili caramel pork belly. The five-room Payot spa books out well in advance.



▶ **GYM:** The expansive 8,000-square-foot gym at **Chicago O'Hare's Hilton** ($11/admission) has everything you'll need for a pre-flight workout, including treadmills, stationary bikes, free weights—even gym shorts.

▶ **POOL:** At Marriott's **Renaissance Concourse Atlanta Airport Hotel** (from $199/night), the glass-enclosed indoor pool gives guests a prime view of takeoffs and landings.

▶ **AIRPORT FOOD: One Flew South**, in Atlanta's Hartsfield-Jackson, is a fine-dining restaurant with a southern accent, serving barbecued scallops and pan-roasted snapper with grits and collard greens. It also offers a separate sushi menu.

▶ **ARCHITECTURE:** Madrid's $7.2 billion **Barajas Terminal**, designed by Richard Rogers, features an undulating ceiling and an airy, luminous arrivals hall. In 2006 it won the prestigious Stirling Prize.

▶ **ENTERTAINMENT:** Singapore's **Changi** has three theaters featuring stadium-style seats that screen movies and TV shows 24 hours per day free of charge. Changi also offers free Internet and Xbox lounges.

▶ **DOMESTIC LOUNGE (MEMBERS-ONLY):** The top of the three-tiered, $10 million **Lufthansa Lounge** at JFK's Terminal 1 has white-linen dining and private showers, and is reserved for First Class passengers. The bottom tier (open to Star Alliance frequent fliers) is catered by Vienna's DO & Co and offers a full bar. Ⓑ



Stumping For Chocolate

Former Bush aides–and siblings–Dana Manatos and Christian Edwards scored a coup by getting a 1,500-square-foot retail space in the Pentagon



A brother and sister left the White House to rebrand a family business. *By Alexandra Wolfe*

Few former Bush aides still have a foothold in the Pentagon, but Christian Edwards and his sister, Dana Manatos–both of whom were aides for President George W. Bush–are more firmly ensconced there than ever. This time, as chocolatiers.

Edwards, 33, landed a job in the White House's advance office after volunteering on Bush's 2000 campaign. When Manatos graduated from college in 2003, she joined him. While Edwards traveled with Bush, Manatos, 30, plotted the President's schedule in five-minute slots. Both were promoted in 2005, but after years of sleeping with their BlackBerrys decided to leave during the summer of 2007. "It was a difficult decision," says Edwards. "We got to know the President in a way most people couldn't."

Instead of leveraging their connections into government jobs, they chose to revive Chocolate Celebrations, the Pittsburgh-based business that had been in their family for nearly a century. To reposition the business as a national gourmet brand, Edwards and Manatos raised $150,000 in personal funds and bank loans. For two years they experimented with recipes and packaging while setting up contracts with vendors. (The project was delayed when Edwards became Sarah Palin's deputy chief of staff in late 2008.) In 2009, they took the renamed company, Edward Marc Chocolatier, to market and brought on their younger brother, who, as "chief candy maker," had devised a menu of new flavors.

Their biggest coup was landing a coveted 1,500-square-foot boutique in the Pentagon this February. The location helped them win contracts with the State Dept., embassies, and members of Congress. "Working at the White house opened their horizons for what the family business could go into," says Dana Perino, Bush's former press secretary. "If you hadn't worked [there], you really wouldn't think your chocolate company could get a contract with the Department of Defense."

The siblings are planning stores for New York, Los Angeles, and Georgetown. Meanwhile, they're adding clients from both sides of the aisle–Secretary of State Hillary Clinton among them. Says Edwards, "The chocolate business is nonpartisan." Ⓑ

Edward Marc's chocolate-covered large pretzels; a box of 12 costs $20



WHEN LIFE IS A BOX OF CHOCOLATES

250,000
Pounds of cocoa used by Edward Marc this year, up from 30,000 three years ago

47
Percent increase in the chocolate company's sales from 2008 to 2009

$150,000
Money raised in 2007 to begin rebranding the family's chocolate business

18,968
Number of fresh-dipped strawberries sold since Feb. 1, at $29.95 a pound

DATA: EDWARD MARC CHOCOLATIER

TOP: PHOTOGRAPH BY ANDREW HETHERINGTON FOR BLOOMBERG BUSINESSWEEK

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Ear's Looking at You, Kid

Videocam + Bluetooth = Looxcie, the latest offering in the growing geekonomy. *By Rich Jaroslovsky*

There's a certain dorkiness to the Looxcie, a new video camera that you wear as if it were a hands-free cell-phone headset. It makes you feel like you're on the way to the nearest *Star Trek* convention dressed as a member of the Borg. As the latest offering in the ever-growing geekonomy, that's part of the appeal. It incorporates some cool ideas, even if they aren't yet fully developed.

At five inches long, the Looxcie (pronounced "look-see") is larger than a phone headset, though it weighs only about an ounce. It consists of a thick hook that fits over your ear and a slender cylinder that houses the lens, microphone, and indicator lights. The Looxcie is designed to be always on, capturing everything you see as you see it. It'd be great to use to record your niece's soccer game without having to squint or keep your arm up for hours.

To use the Looxcie, which costs $199, you first sync it via Bluetooth to your smartphone and download a free app that turns the phone into a viewfinder, remote control, and video monitor. The camera runs for up to four hours between charges and stores five hours of content in its internal memory, overwriting old stuff with new except for what you choose to save or share. The press of a button will automatically create and e-mail a video clip of the last 30 seconds to a predetermined recipient. You can also use your phone to review everything you've shot, create a clip manually, and send it to friends or to YouTube, Facebook, or Twitter. There's also a USB cable for downloading the camera's contents onto a personal computer.

Looxcie is harder to operate than it should be, though. It takes a lot of trial and error to get it comfortable, stable, and properly aimed. The controls are fussy and indicator lights are tiny and hard to see in sunlight. The video isn't bad–it turns out your head makes a pretty decent tripod if you stand reasonably still, and the camera does a good job of automatically adapting to different lighting conditions. However, at 15 frames a second and 480x320 resolution, it ain't *Avatar*–or even an iPhone 4. That brings up a greater drawback: At the moment, the camera works only with phones running a recent edition of Google's Android operating system. The company says iPhone and BlackBerry versions are in the works.

Some people will probably find the prospect of always-recording video capture exciting; others might regard it as kind of creepy. Like it or not, it's here. As the Borg would say, resistance is futile. B



LOOXCIE

The $199 device currently works only with phones using a recent version of Google's Android operating system

TOP: PHOTOGRAPH BY JAMIE CHUNG FOR BLOOMBERG BUSINESSWEEK

Diamonds Are A Guy's Best Friend

Amid the recession, jewelry is increasingly viewed as valuable art. Guess who's buying it? *By Rachel Wolff*

What do the following trinkets have in common: Jackie O's gold handbag; Joan Crawford's Raymond Yard tennis bracelet; journalist and ambassador Clare Boothe Luce's gold, diamond, and sapphire necklace; and automobile heiress Bernice Chrysler Garbisch's Van Cleef & Arpels diamond and ruby earrings? If you guessed they were the inventory of a Hearst heiress' safe deposit box, you'd be wrong. They're all, ahem, valuable works of art.

These pieces are included in the Museum of the City of New York's current "Notorious & Notable: 20th Century Women of Style" show. It's the latest in a growing number of exhibitions treating vintage jewels and accessories as miniature sculptures and objets d'art.

With the art market still very much in recovery mode, collectors are turning to jewelry not only for its artistic value but also for its investment potential. "Since the start of the recession we've seen a growing number of new and established collectors come into the market with particular interest in buying jewels as an alternative asset or as a hedge against inflation," says Rahul Kadakia, Christie's head of jewelry.

Feeding the craze, museums and galleries around the world are hosting more historical and thematic exhibitions than ever dedicated to 19th and 20th century jewelry. Last year, Lalique and Cartier curated museum shows that toured the country. Next year, Van Cleef & Arpels will mount a retrospective of its work at the Cooper-Hewitt National Design Museum in New York. "The public's perception of jewelry has absolutely changed. Clients and collectors now have a greater appreciation for fine jewelry as an art form," says Kadakia.



The Bulgari Blue Diamond ring could fetch more than $12 million at Christie's this month

To a point. Many savvy collectors are also drawn to such pieces because of the increase in the investment value of diamonds and gold, and recent auction sales have reflected this enthusiasm. Kadakia cites Cartier's multicolored-gem-encrusted "Tutti Frutti" bracelet as an example of the market's extraordinary growth. The limited-edition designer piece fetched about $300,000 at auction 10 years ago. Today prices consistently exceed $1 million. In April, Sotheby's sold a gold, platinum, and diamond David Webb panther bracelet for $134,500, nearly three times its pre-sale estimate. That same month, Christie's sold a diamond and emerald brooch once belonging to Catherine the Great for $1.65 million—$400,000 more than its anticipated price.

More experienced collectors are trending toward unique period jewels and pieces from top-tier jewelry houses. It's a good strategy, Kadakia says, one that has canny buyers seeing positive returns over the long term. One example of a period piece with currency is the Bulgari Blue Diamond ring, a gold band flanked by two enormous triangular diamonds, which will headline Christie's New York's Jewels sale this month. Purchased for $1 million in the 1970s, when it was designed, Christie's expects it to field more than $12 million this time around.

As with many art world trends, this one has also been fueled, in part, by creative marketing strategies. Lisa Hubbard, Sotheby's jewelry specialist, says auction houses have been exhibiting jewelry lots alongside big-ticket paintings and sculptures. This has helped create demand, she says, because it makes jewelry appear relatively affordable. "It's all great art," Hubbard says. "But we've generated a great deal of interest in the jewelry sales by exhibiting it this way."

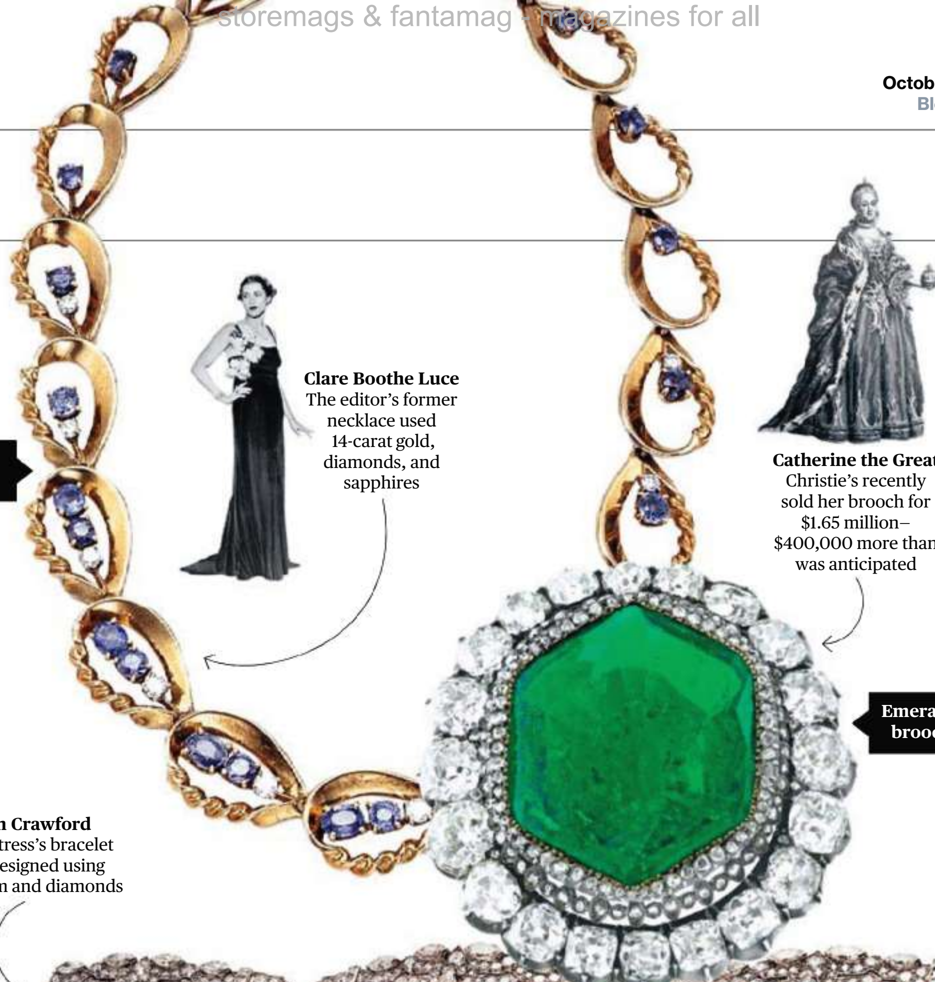
Rising prices may explain the somewhat unlikely reality that "the biggest, most important jewelry collectors are men," says Judith Price, president of the National Jewelry Institute and co-curator of "Notorious & Notable." Citing historical examples such as publisher Jock Whitney, Price suggests this isn't as weird as it seems. "Men don't want to wear the jewelry, but they don't necessarily want their wives or daughters wearing it either," she says. "They see it as an object of art, like a Picasso or Miró. I know it sounds strange, but they want them."

It doesn't sound strange—it just doesn't necessarily sound like art. Diamonds, whether they once hung from Clare Boothe Luce's neck or not, may well become an investor's best friend. Hubbard notes that male collectors are currently coveting pendants and rings with large colorless, D-grade diamonds. They're "cash in the bank," she says, adding that the recession has sent her a slew of new customers. "Stones are portable wealth, and they are part of a global market," Hubbard continues. "It's something that Wall Street is really looking at now. When the stock market and real estate are unpredictable, what's predictable? Diamonds." B

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Tiffany necklace (1935-54)

Clare Boothe Luce
The editor's former necklace used 14-carat gold, diamonds, and sapphires

Catherine the Great
Christie's recently sold her brooch for $1.65 million–$400,000 more than was anticipated

Emerald and diamond brooch (c. mid-18th)



Joan Crawford
The actress's bracelet was designed using platinum and diamonds



Raymond Yard tennis bracelet (1932)



Yellow handbag, maker unknown (1970)



Jacqueline Onassis
The former First Lady's handbag is made of intricately carved yellow gold



Bernice Chrysler Garbisch
The auto heiress and art collector's earrings are studded with rubies and diamonds



Van Cleef & Arpels earclips (1941)

According to the author, Coca-Cola is responsible for exploitation and, gulp, maybe even murder



Coke's Got An America Problem

What are the responsibilities of multinationals? And muckraking journalists? *By Paul M. Barrett*

A quick note to Coca-Cola's PR office: Let's stipulate that you deny just about everything in this book, starting with Michael Blanding's initial assertion that the company's 19th century patent medicine was laced with cocaine. A writer for *The Nation*, *The New Republic*, and other magazines, Blanding thoroughly chronicles the company's every major misstep and act of hypocrisy. He doesn't explore new terrain, but he raises important questions about what we can expect of major companies–and from muckraking journalism.

According to *The Coke Machine: The Dirty Truth Behind the World's Favorite Soft Drink*, the world's most successful soda company doesn't just rot your teeth–it's responsible for drought, disease, exploitation, and possibly even murder. It's tough stuff to swallow–and that's basically the point. Among Coca-Cola's vast array of crimes against the human race, says Blanding, are ads that target children and unsophisticated Mexican peasants with messages implying the sugary beverage makes you sexy, happy, and patriotic. Dasani, its bottled water brand, is hardly any better than what comes out of your tap. In India, he alleges, Coca-Cola's bottlers have sucked up scarce water supplies. And in Latin America, the company has shown active disregard for the employees of its local bottlers who get caught in the crossfire of ideological conflict.

There is, as his title states, some "dirty truth" in all these accusations (and, yes, there's more). However, Blanding may be underestimating the sophistication of his audience. A generation of readers informed by Eric Schlosser and Morgan Spurlock won't find it revelatory that a 12-ounce soft drink with 39 grams of sugar doesn't make you sexy. Others, immune to meaningless corporate names like Verizon or Altria, won't be bothered by the fact that the insipidly titled Dasani isn't even as good as the insipidly titled Brita. In a prosperous country suffused with needless frills, are many of us obsessing about $4 cups of coffee? Though he never says it, what may irk Blanding the most is that Coke tastes good–and that's what most consumers care about.

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The Coke Machine: The Dirty Truth Behind the World's Favorite Soft Drink

by Michael Blanding
AVERY, 384 pp, $26



ILLUSTRATION BY YUKO SHIMIZU

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Overseas, there is more nuance to the Coke story than the author admits. In India, Coca-Cola bottlers used a lot of water and may have emitted pollution, but they did not cause drought, as some critics claimed. In fact, the company seems to have done the right thing in closing a big bottling plant that stirred intense local suspicion and resentment.

As for the murder allegation, Blanding recounts how Colombian right-wing paramilitaries killed eight workers in Coke bottling plants in the mid-1990s. The deaths occurred during the hit squads' guerrilla war against unionists and leftist revolutionaries. Through franchise contracts and partial ownership, Coca-Cola exercised influence over the plants but didn't directly control them. Some labor activists believe–without any direct proof–that executives at Coca-Cola's Atlanta headquarters must have orchestrated the deadly union-busting. The corporation protested its innocence, and U.S. judges summarily dismissed a suit seeking to hold it liable.

As Blanding rails on, it's difficult to avoid the suspicion that his objections are rooted less in a deep dissatisfaction with Coke than in one with capitalism itself. Take his portrait of Asa G. Candler, the Atlanta pharmacist who incorporated the company in 1892. Candler was, by most accounts, a visionary whose franchise system spread financial risk to independently owned bottlers and made Coca-Cola an engine of Atlanta's growth. Introspective and austere, he pondered the duties a tycoon owed his community. Blanding describes this apparently genuine inner struggle with condescension. Candler, he writes, was ashamed of the "obscene profits he made from such an ephemeral product." Throughout the book, profits are described with disdain, as though the purpose of business is to go broke. The author adds: "Candler was deeply ambivalent about the power of altruism–happy to give his money away for the greater good when he was in control of who received it." What's so bad about that?

It's an unfortunate reality that owners and executives live much better than factory workers. On the other hand, factory workers have jobs that feed their families and, one hopes, allow them to send their children to college to one day become executives, themselves, or poets. Advertising may annoy and distract, but it also helps move the products that keep the factories running–and who doesn't enjoy those Coke-drinking polar bears?

A more balanced view of Blanding's evidence suggests that Coca-Cola turned into what most large companies become over time: an amoral, earnings-driven, potentially harmful, but also potentially beneficial, employment- and tax-generating bureaucracy. By this point, we all know that Coke is not exactly a health beverage, and that the company is less than a crusader for human rights. Doing business in chaotic, violent countries presents a real dilemma to multinational corporations. People in Colombia may not need Coke, but they seem to like it and they can use the bottling jobs. Without a doubt, the company has had some very bad ideas, and not just New Coke. For years, it paid public school districts to get soda machines into cafeterias. Yet it seems highly relevant that school superintendents eagerly took the company's money, until activists blew the whistle. The lesson? Beware corporations suggesting quid pro quo arrangements; they're not driven by generosity.

Critical assessments of powerful corporations–whether from regulators, activists, or journalists–provide a vital check on free-market excess. The problem with a litany of undifferentiated accusations, however, is that it denies ambiguous reality. Simplistic screeds undercut the credibility of legitimate consumer protectionism and relieve the rest of us of our responsibility to exercise common sense. B

Will readers be shocked that a 12-ounce can with 39 grams of sugar doesn't actually make you sexy, as ads suggest?

Soda & Gomorrah

As a large multinational corporation, Coca-Cola has committed its fair share of missteps. Here are four memorable setbacks for the brand:



DROUGHTS

Coca-Cola has faced intense criticism that its bottling plants in some regions–particularly southern India–siphon off scarce groundwater and emit contamination. Coke denies that it has had any deleterious effect on its neighbors but closed a plant in Kerala in 2004 after it came under attack.



NEW COKE

Introduced in 1985, this reformulated version of the company's basic soda flopped with consumers. The failure led to the return of "Classic Coke," prompting some skeptics to speculate that the company might have staged the entire episode to draw attention to the revival of the original flavor.



DASANI

Coca-Cola has faced criticism that its Dasani brand, launched in 1999, generates unnecessary plastic pollution–and that the water is little different from free tap water. Coke markets Dasani as a healthy alternative to high-calorie beverages and urges consumers to recycle bottles and cans.



MURDER

Coca-Cola suffered a PR nightmare and litigation when right-wing militiamen killed bottling plant workers in Carepa, Colombia, in the mid-1990s during a labor rights struggle. U.S. judges dismissed the case, but Coke has stepped up monitoring of labor relations in conflict-prone nations.

PIPE: THOMAS LOTTERMOSER/GETTY IMAGES; FAUCET: OCEAN/CORBIS; GUN: FUSE/GETTY IMAGES

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Etc. Hard Choices

Annise Parker

“When I was sworn in as mayor... the media attention worldwide was overwhelming. ‘Houston elected a lesbian? *Houston?*’ ”

America’s first lesbian big-city mayor on her sexuality, receiving death threats, and struggling with the public part of the job



People assume the toughest decision in my life was coming out. But being gay isn’t tough—it’s who I am. What’s been tough is learning how to be social, and how to adapt to public life.

I’d lost two city council elections before—in 1991 and again in 1995. Every time I saw my name in print, there would be a reference to my orientation. It was as if “lesbian” was my last name. It was frustrating that it was the only thing people cared about. But when you have a public career, there are no boundaries. During a mayoral debate, some guy jumped up and said, “You’ve never once mentioned your gay agenda for the city of Houston.” I responded that I was talking about my agenda for the city of Houston. I didn’t tell people I was a candidate who happened to be gay. Nobody wants to hear that. I learned it’s a distinction you show, not one you say.

Being a lesbian can make other people uncomfortable. Though there are also people who, if you get them past that issue, will treat it as a plus. They almost say to themselves, “If she’ll tell me that, she’ll tell me anything.” Public office may not come naturally, but I’ve learned to put up with the scrutiny. When I was sworn in as mayor of Houston, the media attention worldwide was overwhelming. “Houston elected a lesbian? *Houston?*” I was even on the front page of the *Times of India*. It has given me a fantastic opportunity to change how people think about my city. I take a lot of credit for raising Houston’s coolness factor.

I don’t get death threats anymore, but I still have to work at being comfortable with the public part of the job. There are so many more images of gay and lesbian people today, and so many ways to be gay. I’m a middle-aged soccer mom and I appear in public with my spouse of 20 years and my kids. It’s hard to make me scary. When the job is over for the evening, I go home and pull up the drawbridge. It’s a relief when the scrutiny isn’t there. But being honest about my personal life pays off every day. B

—As told to Diane Brady

PHOTOGRAPH BY MIKE MCGREGOR FOR BLOOMBERG BUSINESSWEEK

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